

Western Asset Mortgage Defined Opportunity Fund Inc.  
Form N-CSR  
February 25, 2015

**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 811-22369

**Western Asset Mortgage Defined Opportunity Fund Inc.**

(Exact name of registrant as specified in charter)

620 Eighth Avenue, 49th 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: December 31**

**Date of reporting period: December 31, 2014**

ITEM 1. REPORT TO STOCKHOLDERS.

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

Annual Report

December 31, 2014

WESTERN ASSET

MORTGAGE DEFINED OPPORTUNITY FUND  
INC. (DMO)

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

<b>What's inside</b>	
<a href="#">Letter from the chairman</a>	II
<a href="#">Investment commentary</a>	III
<a href="#">Fund overview</a>	1
<a href="#">Fund at a glance</a>	6
<a href="#">Spread duration</a>	7
<a href="#">Effective duration</a>	8
<a href="#">Schedule of investments</a>	9
<a href="#">Statement of assets and liabilities</a>	22
<a href="#">Statement of operations</a>	23
<a href="#">Statements of changes in net assets</a>	24
<a href="#">Statement of cash flows</a>	25
<a href="#">Financial highlights</a>	26
<a href="#">Notes to financial statements</a>	27
<a href="#">Report of independent registered public accounting firm</a>	43
<a href="#">Board approval of management and subadvisory agreements</a>	44
<a href="#">Additional information</a>	50
<a href="#">Annual chief executive officer and principal financial officer certifications</a>	56
<a href="#">Other shareholder communications regarding accounting matters</a>	57
<a href="#">Dividend reinvestment plan</a>	58
<a href="#">Important tax information</a>	60

## Fund objectives

The Fund's primary investment objective is to provide current income. As a secondary investment objective, the Fund will seek capital appreciation.

## Letter from the chairman

### Dear Shareholder,

We are pleased to provide the annual report of Western Asset Mortgage Defined Opportunity Fund Inc. for the twelve-month reporting period ended December 31, 2014. Please read on for a detailed look at prevailing economic and market conditions during the Fund's reporting period and to learn how those conditions have affected Fund performance.

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,

Edgar Filing: Western Asset Mortgage Defined Opportunity Fund Inc. - Form N-CSR

Kenneth D. Fuller

Chairman, President and Chief Executive Officer

January 30, 2015

II Western Asset Mortgage Defined Opportunity Fund Inc.

## Investment commentary

### Economic review

Despite weakness in early 2014, the U.S. economy expanded at a solid pace during the twelve months ended December 31, 2014 (the reporting period). The U.S. Department of Commerce reported that in the first quarter of 2014, U.S. gross domestic product (GDP) contracted 2.1%. This was the first negative GDP report in three years and partially attributed to severe winter weather. Thankfully, this setback was very brief, as second quarter GDP growth was 4.6%. The rebound in GDP growth was driven by several factors, including an acceleration in personal consumption expenditures (PCE), increased private inventory investment and exports, as well as an upturn in state and local government spending. The economy then gained further momentum as third quarter GDP growth was 5.0%, its strongest reading since the third quarter of 2003. This was driven by contributions from PCE, exports, nonresidential fixed investment and government spending. After the reporting period ended, the U.S. Department of Commerce's initial estimate showed that fourth quarter 2014 GDP growth was 2.6%. Moderating growth was due to several factors, including an upturn in imports, a downturn in federal government spending and decelerations in nonresidential fixed investment and in exports.

The U.S. manufacturing sector was another tailwind for the economy. Based on figures for the Institute for Supply Management's Purchasing Managers' Index (PMI), U.S. manufacturing expanded during all twelve months of the reporting period (a reading below 50 indicates a contraction, whereas a reading above 50 indicates an expansion). After a reading of 56.5 in December 2013, the PMI fell to 51.3 in January 2014, but generally rose over the next several months, reaching a high of 59.0 in August, its best reading since March 2011. While the PMI dipped to 56.6 in September, it rose back to 59.0 in October. Manufacturing activity then moderated over the last two months of the year and the PMI was 55.5 in December. However, for 2014 as a whole the PMI averaged 55.8, the best annual reading since 2010.

The improving U.S. job market was another factor supporting the overall economy during the reporting period. When the period began, unemployment, as reported by the U.S. Department of Labor, was 6.6%. Unemployment generally declined throughout the reporting period and reached a low of 5.6% in December 2014, the lowest level since June 2008.

The Federal Reserve Board (Fed) took a number of actions as it sought to meet its dual mandate of fostering maximum employment and price stability. As it has since December 2008, the Fed kept the federal funds rate<sup>iv</sup> at a historically low range between zero and 0.25%. The Fed also ended its asset purchase program that was announced in December 2012. At that time, the Fed said it would continue purchasing \$40 billion per month of agency mortgage-backed securities (MBS), as well as \$45 billion per month of longer-term Treasuries. Following the meeting that concluded on December 18, 2013, the Fed announced that it would begin reducing its monthly asset purchases, saying "Beginning in January 2014, the Committee will add to its holdings of agency MBS at a pace of \$35 billion per month rather than \$40 billion per month, and will add to its holdings of longer-term Treasury securities at a pace of \$40 billion per month rather than \$45 billion per month. At each of the Fed's next six meetings (January, March, April, June, July and September 2014), it announced further

## Investment commentary (cont d)

\$10 billion tapering of its asset purchases. At its meeting that ended on October 29, 2014, the Fed announced that its asset purchase program had concluded. During its last meeting of the year that concluded on December 17, 2014, the Fed said that “Based on its current assessment, the Committee judges that it can be patient to maintain the 0 to 1/4 percent target range for the federal funds rate for a considerable time.” Finally, at its meeting that ended on January 28, 2015, after the reporting period ended, the Fed said “Based on its current assessment, the Committee judges that it can be patient in beginning to normalize the stance of monetary policy.”

As always, thank you for your confidence in our stewardship of your assets.

Sincerely,

Kenneth D. Fuller

Chairman, President

and Chief Executive Officer

January 30, 2015

All investments are subject to risk including the possible loss of principal. Past performance is no guarantee of future results.

<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 Institute for Supply Management’s PMI is based on a survey of purchasing executives who buy the raw materials for manufacturing at more than 350 companies. It offers an early reading on the health of the U.S. manufacturing sector.

<sup>iii</sup> 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.

<sup>iv</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.



## Fund overview

### Q. What is the Fund's investment strategy?

A. The Fund's primary investment objective is to provide current income. As a secondary investment objective, the Fund will seek capital appreciation. The Fund seeks to achieve its investment objectives by investing primarily in a diverse portfolio of mortgage-backed securities ( MBS ), consisting primarily of non-agency residential mortgage-backed securities ( RMBS ) and commercial mortgage-backed securities ( CMBS ).

The Fund also may invest, to a lesser degree, in other permitted investments, including cash and cash equivalents; Treasury securities; non-mortgage related asset-backed securities ( ABS ) backed by various asset classes including, but not limited to, small balance commercial mortgages, aircrafts, automobiles, credit cards, equipment, manufactured housing, franchises, recreational vehicles and student loans; and investment grade and below investment grade fixed income securities including bonds, debentures, notes, commercial paper and other similar types of debt instruments including hybrid securities. The Fund also may invest in any newly developed mortgage related derivatives that may hereafter become available for mortgage investing.

The Fund may invest in derivative instruments, such as options contracts, futures contracts, options on futures contracts, indexed securities, credit linked notes, credit default swaps and other swap agreements for investment, hedging and risk management purposes with certain limitations. Notwithstanding the foregoing, the Fund may invest without limitation in Treasury futures, Eurodollar futures, interest rate swaps, swaptions or similar instruments and combinations thereof.

The Fund is not limited in its ability to invest in below investment grade or illiquid securities. Below investment grade securities are securities rated below the Baa or BBB categories at the time of purchase by one or more nationally recognized statistical rating organizations or unrated securities that we determine to be of comparable quality.

At Western Asset Management Company ( Western Asset ), the Fund's subadviser, we utilize a fixed-income team approach, with decisions derived from interaction among various investment management sector specialists. The sector teams are comprised of Western Asset's senior portfolio management personnel, research analysts and an in-house economist. Under this team approach, management of client fixed-income portfolios will reflect a consensus of interdisciplinary views within the Western Asset organization. The individuals responsible for development of investment strategy, day-to-day portfolio management, oversight and coordination of the Fund are S. Kenneth Leech, Greg E. Handler and Anup Agarwal.

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

A. The U.S. spread sectors (non-Treasuries) generated positive results and largely outperformed equal-duration<sup>1</sup> Treasuries over the twelve months ended December 31, 2014. Risk aversion was prevalent at times given mixed economic data, questions surrounding the outlook for global growth, changing monetary policy by the Federal Reserve Board ( Fed ), and numerous geopolitical issues. However, these factors

## Fund overview (cont d)

were largely overshadowed by solid demand from investors looking to generate incremental yield in the low interest rate environment.

Short-term Treasury yields moved higher, whereas longer-term Treasury yields declined during the twelve months ended December 31, 2014. Two-year Treasury yields rose from 0.38% at the beginning of the period to 0.67% at the end of the period. Their peak of 0.73% occurred on December 23, December 24 and December 26, 2014, and they were as low as 0.30% in early February 2014. Ten-year Treasury yields were at a peak of 3.04% when the reporting period began and reached a low of 2.07% on December 16, 2014. They ended the reporting period at 2.17%. All told, the Barclays U.S. Aggregate Index<sup>iii</sup> returned 5.97% for the twelve months ended December 31, 2014.

As was the case for the overall fixed-income market, agency MBS generated solid results during the reporting period. Agency MBS were supported by declining interest rates and generally solid demand. During the twelve months ended December 31, 2014, the overall agency MBS market, as measured by the Barclays U.S. Mortgage Backed Securities Index<sup>iv</sup>, returned 6.08%. Elsewhere, RMBS, as measured by the BofA Merrill Lynch U.S. Floating Rate Home Equity Loan Asset Backed Securities Index<sup>v</sup>, returned 3.33%. While CMBS also produced positive results during the twelve months ended December 31, 2014, they underperformed the overall fixed-income market, as the Barclays CMBS Index<sup>vi</sup> gained 4.21%.

### Q. How did we respond to these changing market conditions?

A. We made several adjustments to the Fund's portfolio during the reporting period. We reduced our exposure to option adjustable-rate mortgage ( ARM ) agency MBS and modestly pared our allocation to investment grade corporate bonds. In contrast, we increased our exposures to Alt-A non-agency MBS, government sponsored enterprise ( GSE ) risk-transfer securities and CMBS.

During the reporting period, Treasury futures were used to manage duration and yield curve<sup>vii</sup> exposure. Credit default swaps on CMBS indices were used to hedge downside market risk. Elsewhere, we used foreign exchange forwards to hedge our currency exposure to euro-denominated CMBS. Overall, these derivatives did not meaningfully impact performance.

Finally, we actively utilized leverage in the Fund. When the reporting period began, the Fund's leverage as a percentage of gross assets was roughly 34%. At the end of the period, approximately 33% of the Fund's gross assets were levered. The use of leverage was beneficial for the Fund's absolute performance during the period.

### Performance review

For the twelve months ended December 31, 2014, Western Asset Mortgage Defined Opportunity Fund Inc. returned 17.55% based on its net asset value ( NAV<sup>iii</sup>) and 16.76% based on its New York Stock Exchange ( NYSE ) market price per share. The Fund's unmanaged benchmark, the BofA Merrill Lynch U.S. Floating Rate Home Equity Loan Asset Backed Securities Index, returned 3.33% for the same period. The Lipper U.S. Mortgage Closed-End Funds

Category Average<sup>ix</sup> returned 7.80% over the same time frame. Please note that Lipper performance returns are based on each fund's NAV.

During the twelve-month period, the Fund made distributions to shareholders totaling \$3.09 per share.\* The performance table shows the Fund's twelve-month total return based on its NAV and market price as of December 31, 2014. **Past performance is no guarantee of future results.**

**Performance Snapshot** as of December 31, 2014

Price Per Share	12-Month Total Return**
\$24.75 (NAV)	17.55%
\$23.84 (Market Price)	16.76%

**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. 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 at NAV.**

**Total return assumes the reinvestment of all distributions in additional shares in accordance with the Fund's Dividend Reinvestment Plan.**

**Q. What were the leading contributors to performance?**

**A.** On an absolute basis, the leading contributor to the Fund's performance during the reporting period was its allocation to non-agency MBS. Non-agency MBS were supported by generally strong investor demand, attractive yields, continued principal paydowns and limited new supply. The Fund's allocations to ABS and CMBS were also additive to performance. Elsewhere, the Fund's investment-grade and high-yield corporate bonds were beneficial for performance.

In terms of the Fund's investment-grade bond holdings, Noble Group and United Airlines were among the best performers. Standout high-yield corporate bond holdings included Cemex, William Lyon Homes and Vedanta Resources PLC.

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

**A.** Select structured securities and GSE risk-transfer securities detracted from absolute performance during the reporting period.

**Looking for additional information?**

The Fund is traded under the symbol **DMO** and its closing market price is available in most newspapers under the NYSE listings. The daily NAV is available on-line under the symbol **XDMOX** 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).

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.

\*For the tax character of distributions paid during the fiscal year ended December 31, 2014, please refer to page 42 of this report.

## Fund overview (cont d)

Thank you for your investment in Western Asset Mortgage Defined Opportunity Fund 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 Company

January 20, 2015

***RISKS:** The Fund's investments are subject to liquidity risk, credit risk, inflation risk and interest rate risk. As interest rates rise, bond prices fall, reducing the value of the Fund's fixed-income holdings. The Fund may invest in lower-rated high-yield bonds which are subject to greater credit risk (risk of default) than higher-rated obligations. Mortgage-backed securities are subject to additional risks, including prepayment risk, which can limit the potential gains in a declining interest rate environment. The Fund may invest in securities backed by subprime or distressed mortgages which involve a higher degree of risk and chance of loss. Leverage may result in greater volatility of NAV and the market price of common shares and increases a shareholder's risk of loss. The Fund may make significant investments in derivative instruments. Derivative instruments can be illiquid, may disproportionately increase losses, and have a potentially large impact on Fund performance. The Fund is not guaranteed by the U.S. government, the U.S. Treasury or any government agency.*

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.

- <sup>i</sup> Duration is the measure of the price sensitivity of a fixed-income security to an interest rate change of 100 basis points. Calculation is based on the weighted average of the present values for all cash flows.
- <sup>ii</sup> 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.
- <sup>iii</sup> The 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>iv</sup> The Barclays U.S. Mortgage-Backed Securities Index is an unmanaged index composed of agency mortgage-backed pass-through securities, both fixed-rate and hybrid adjustable rate mortgages, issued by the Government National Mortgage Association, Federal National Mortgage Association and Federal Home Loan Mortgage Corporation.
- <sup>v</sup> The BofA Merrill Lynch U.S. Floating Rate Home Equity Loan Asset Backed Securities Index tracks the performance of U.S. dollar-denominated investment grade floating-rate asset-backed securities collateralized by home equity loans publicly issued in the U.S. domestic market. Qualifying securities must have an investment grade rating, at least one year remaining to final stated maturity, a floating-rate coupon, and an original deal size for the collateral group of at least \$250 million.
- <sup>vi</sup> The Barclays CMBS Index measures the performance of the commercial mortgage-backed securities market.
- <sup>vii</sup> The yield curve is the graphical depiction of the relationship between the yield on bonds of the same credit quality but different maturities.
- <sup>viii</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>ix</sup> Lipper, Inc., a wholly-owned subsidiary of Reuters, provides independent insight on global collective investments. Returns are based on the twelve-month period ended December 31, 2014, including the reinvestment of all distributions, including returns of capital, if any, calculated among the 10 funds in the Fund's Lipper category.

## 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 December 31, 2014 and December 31, 2013. This bar graph does not include derivatives, such as futures contracts, forward foreign currency contracts and swap contracts. The Fund is actively managed. As a result, the composition of the Fund's investments is subject to change at any time.

## Spread duration (unaudited)

Economic exposure December 31, 2014

### Total Spread Duration

DMO 4.30 years

Benchmark 3.82 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.

ABS	Asset-Backed Securities
Benchmark	BofA Merrill Lynch U.S. Floating Rate Home Equity Loan Asset-Backed Securities Index
DMO	Western Asset Mortgage Defined Opportunity Fund Inc.
EM	Emerging Markets
HY	High Yield
IG Credit	Investment Grade Credit
MBS	Mortgage-Backed Securities

## Effective duration (unaudited)

Interest rate exposure December 31, 2014

Total Effective Duration  
DMO 4.24 years  
Benchmark 0.05 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.

ABS	Asset-Backed Securities
Benchmark	BofA Merrill Lynch U.S. Floating Rate Home Equity Loan Asset-Backed Securities Index
DMO	Western Asset Mortgage Defined Opportunity Fund Inc.
EM	Emerging Markets
HY	High Yield
IG Credit	Investment Grade Credit
MBS	Mortgage-Backed Securities



## Schedule of investments

December 31, 2014

### Western Asset Mortgage Defined Opportunity Fund Inc.

Security	Rate	Maturity Date	Face Amount	Value
<b>Residential Mortgage-Backed Securities 115.3%</b>				
ABFS Mortgage Loan Trust, 2002-3 M1	5.902%	9/15/33	1,275,658	\$ 1,029,602
Accredited Mortgage Loan Trust, 2003-3 A1	5.210%	1/25/34	1,256,386	1,226,994
AFC Home Equity Loan Trust, 2003-3 1A	0.920%	10/25/30	2,109,051	1,876,275 (a)(b)
American Home Mortgage Assets, 2005-2 2A1A	2.951%	1/25/36	1,762,686	1,231,248 (a)(c)
American Home Mortgage Assets, 2006-4 1A12	0.380%	10/25/46	2,833,656	1,925,183 (a)(c)
American Home Mortgage Investment Trust, 2005-1 6A	2.327%	6/25/45	122,267	119,656 (a)(c)
American Home Mortgage Investment Trust, 2005-SD1 1A1	0.620%	9/25/35	362,233	279,522 (a)(b)(c)
American Home Mortgage Investment Trust, 2007-2 11A1	0.400%	3/25/47	1,350,923	844,905 (a)(c)
American Home Mortgage Investment Trust, 2007-2 2A	0.970%	3/25/47	13,293,270	1,806,655 (a)
American Home Mortgage Investment Trust, 2007-A 4A	1.055%	7/25/46	2,668,731	1,012,031 (a)(b)(c)
Ameriquest Mortgage Securities Inc., 2002-4 M3	5.420%	2/25/33	2,034,344	1,730,895 (a)
Ameriquest Mortgage Securities Inc., 2002-D M1	3.905%	2/25/33	2,220,000	1,690,621 (a)
Argent Securities Inc., 2005-W5 A2D	0.490%	1/25/36	4,524,176	3,545,185 (a)
Argent Securities Inc., 2006-M2 A2B	0.280%	9/25/36	3,777,362	1,481,893 (a)
Argent Securities Inc., 2006-M2 A2C	0.320%	9/25/36	2,607,015	1,027,632 (a)
Argent Securities Inc., 2006-M2 A2D	0.410%	9/25/36	688,069	273,999 (a)
Argent Securities Inc., 2006-M3 A2C	0.330%	10/25/36	4,240,749	1,886,090 (a)
ARM Trust, 2005-05 1A1	2.576%	9/25/35	342,073	272,332 (a)(c)
ARM Trust, 2005-07 2A21	2.575%	10/25/35	1,040,000	948,773 (a)(c)
ARM Trust, 2005-10 1A21	2.627%	1/25/36	433,780	378,194 (a)(c)
ARM Trust, 2005-12 5A1	0.420%	3/25/36	429,963	277,154 (a)(c)
Asset-Backed Funding Certificates, 2005-HE1 M2	0.830%	3/25/35	2,730,567	2,170,369 (a)
Banc of America Alternative Loan Trust, 2005-9 1CB5, IO	4.931%	10/25/35	6,991,566	1,016,032 (a)
Banc of America Funding Corp., 2004-B 6A1	3.728%	12/20/34	612,677	444,383 (a)(c)
Banc of America Funding Corp., 2004-C 3A1	2.872%	12/20/34	899,531	803,098 (a)(c)
Banc of America Funding Corp., 2006-D 2A1	2.820%	5/20/36	150,525	110,503 (a)(c)
Banc of America Funding Corp., 2006-D 6A1	4.828%	5/20/36	1,633,444	1,346,879 (a)(c)
Banc of America Funding Corp., 2006-F 1A1	2.606%	7/20/36	799,284	785,772 (a)(c)
Banc of America Funding Corp., 2006-H 3A1	2.782%	9/20/46	194,503	158,205 (a)(c)
Banc of America Funding Corp., 2014-R5 1A2	1.827%	9/26/45	3,750,000	2,007,750 (a)(b)(c)(d)
Bayview Financial Acquisition Trust, 2007-A 2A	0.520%	5/28/37	1,764,551	1,330,074 (a)(c)
Bayview Financial Asset Trust, 2007-SR1A M1	0.970%	3/25/37	4,333,270	3,750,445 (a)(b)
Bayview Financial Asset Trust, 2007-SR1A M2	1.070%	3/25/37	5,275,584	4,431,491 (a)(b)
Bayview Financial Asset Trust, 2007-SR1A M3	1.320%	3/25/37	2,390,177	1,816,534 (a)(b)
Bayview Financial Asset Trust, 2007-SR1A M4	1.670%	3/25/37	515,866	361,106 (a)(b)
BCAP LLC Trust, 2009-RR4 8A2	2.779%	9/26/35	2,445,453	1,906,060 (a)(b)(c)
BCAP LLC Trust, 2010-RR06 4A13	2.779%	9/26/35	2,004,314	1,544,007 (a)(b)(c)
BCAP LLC Trust, 2010-RR10 2A7	2.817%	12/27/34	5,054,762	4,445,704 (a)(b)(c)

See Notes to Financial Statements.

## Schedule of investments (cont d)

December 31, 2014

## Western Asset Mortgage Defined Opportunity Fund Inc.

Security	Rate	Maturity Date	Face Amount	Value
<b>Residential Mortgage-Backed Securities continued</b>				
Bear Stearns Alt-A Trust, 2005-2 2A4	2.646%	4/25/35	202,587	\$ 195,782 (a)(c)
Bear Stearns Alt-A Trust, 2005-3 4A3	2.454%	4/25/35	411,009	398,095 (a)(c)
Bear Stearns Alt-A Trust, 2005-9 25A1	2.473%	11/25/35	523,317	420,080 (a)(c)
Bear Stearns Alt-A Trust, 2006-2 23A1	2.655%	3/25/36	1,901,627	1,402,996 (a)(c)
Bear Stearns Asset Backed Securities I Trust, 2004-BO1 M9B	4.170%	10/25/34	407,120	380,517 (a)
Bear Stearns Asset-Backed Securities Trust, 2003-SD2 1A	3.586%	6/25/43	82,752	82,760 (a)
Bear Stearns Asset-Backed Securities Trust, 2005-CL1 A1	0.623%	9/25/34	147,242	139,419 (a)
Bear Stearns Mortgage Funding Trust, 2007-AR5 2A1	0.350%	6/25/37	2,289,585	1,955,960 (a)(c)
Centex Home Equity Loan Trust, 2004-D MV1	0.790%	9/25/34	1,421,962	1,276,465 (a)
Chase Mortgage Finance Corp., 2006-S3 2A1	5.500%	11/25/21	313,585	268,500 (c)
Chaseflex Trust, 2005-2 3A3, IO	5.331%	6/25/35	15,269,465	2,378,929 (a)
Chevy Chase Mortgage Funding Corp., 2006-2A A1	0.300%	4/25/47	268,526	214,008 (a)(b)(c)
Citicorp Mortgage Securities Inc., 2007-8 B1	5.947%	9/25/37	4,787,395	2,575,097 (a)(c)
Citigroup Mortgage Loan Trust Inc., 2003-HE4 A	0.580%	12/25/33	32,034	32,080 (a)(b)
Citigroup Mortgage Loan Trust Inc., 2004-HYB3 1A	2.577%	9/25/34	190,028	191,247 (a)(c)
Citigroup Mortgage Loan Trust Inc., 2004-UST1 A2	1.994%	8/25/34	132,066	129,569 (a)(c)
Citigroup Mortgage Loan Trust Inc., 2005-05	1.776%	8/25/35	294,393	236,007 (a)(c)
Citigroup Mortgage Loan Trust Inc., 2005-10 1A1A	0.548%	12/25/35	364,806	321,335 (a)(c)
Citigroup Mortgage Loan Trust Inc., 2006-AR5 2A1A	2.630%	7/25/36	552,678	360,490 (a)(c)
Citigroup Mortgage Loan Trust Inc., 2007-06 1A1A	2.176%	3/25/37	508,530	378,587 (a)(c)
Citigroup Mortgage Loan Trust Inc., 2007-AR8 1A1A	2.585%	8/25/47	550,950	448,756 (a)(c)
Citigroup Mortgage Loan Trust Inc., 2014-6 3A3	3.479%	11/25/35	3,940,331	2,447,339 (a)(b)(c)
Connecticut Avenue Securities, 2013-C01 M2	5.420%	10/25/23	1,260,000	1,365,827 (a)(c)
Connecticut Avenue Securities, 2014-C03 1M2	3.170%	7/25/24	3,750,000	3,392,158 (a)(c)
Countrywide Alternative Loan Trust, 2003-10CB M	5.736%	5/25/33	2,906,920	2,259,639 (a)(c)
Countrywide Alternative Loan Trust, 2005-03CB 1A6, IO	6.981%	3/25/35	816,423	137,653 (a)
Countrywide Alternative Loan Trust, 2005-07CB 1A3, IO	6.431%	4/25/35	1,965,119	204,311 (a)
Countrywide Alternative Loan Trust, 2005-11CB 3A3, IO	4.831%	6/25/35	4,325,672	540,752 (a)
Countrywide Alternative Loan Trust, 2005-14 3A1	2.244%	5/25/35	448,572	320,551 (a)(c)
Countrywide Alternative Loan Trust, 2005-27 2A1	1.463%	8/25/35	3,343,026	2,719,218 (a)(c)
Countrywide Alternative Loan Trust, 2005-27 2A3	1.673%	8/25/35	2,687,467	2,392,939 (a)(c)
Countrywide Alternative Loan Trust, 2005-36 4A1	2.365%	8/25/35	1,114,442	983,700 (a)(c)
Countrywide Alternative Loan Trust, 2005-50CB 1A1	5.500%	11/25/35	599,405	571,715 (c)
Countrywide Alternative Loan Trust, 2005-J10 1A1	0.670%	10/25/35	258,328	205,187 (a)(c)
Countrywide Alternative Loan Trust, 2006-39CB 1A7, IO	5.231%	1/25/37	21,730,631	3,653,202 (a)
Countrywide Alternative Loan Trust, 2006-HY10 1A1	2.035%	5/25/36	786,397	622,939 (a)(c)
Countrywide Alternative Loan Trust, 2006-J8 A5	6.000%	2/25/37	171,740	136,761 (c)
Countrywide Alternative Loan Trust, 2007-23CB A4, IO	6.331%	9/25/37	12,009,073	2,847,027 (a)

See Notes to Financial Statements.

## Western Asset Mortgage Defined Opportunity Fund Inc.

Security	Rate	Maturity Date	Face Amount	Value
<b>Residential Mortgage-Backed Securities continued</b>				
Countrywide Alternative Loan Trust, 2007-3T1 2A1	6.000%	3/25/27	699,106	\$ 678,465 (c)
Countrywide Asset-Backed Certificates, 2005-13 3AV4	0.495%	4/25/36	814,320	748,850 (a)
Countrywide Asset-Backed Certificates, 2006-S3 A2	6.085%	6/25/21	119,388	119,194 (c)
Countrywide Asset-Backed Certificates, 2006-S7 A3	5.712%	11/25/35	597,012	583,630 (a)(c)
Countrywide Asset-Backed Certificates, 2006-S9 A3	5.728%	8/25/36	228,814	226,029 (a)(c)
Countrywide Asset-Backed Certificates, 2006-SD2 1A1	0.520%	5/25/46	232,159	222,697 (a)(b)
Countrywide Asset-Backed Certificates, 2006-SD3 A1	0.500%	7/25/36	1,840,988	1,498,859 (a)(b)
Countrywide Asset-Backed Certificates, 2007-8 M1	0.440%	11/25/37	6,992,663	1,344,790 (a)
Countrywide Asset-Backed Certificates, 2007-SE1 1A1	0.720%	5/25/47	1,156,973	672,459 (a)(b)
Countrywide Home Equity Loan Trust, 2004-B 1A	0.381%	2/15/29	887,288	791,193 (a)(c)
Countrywide Home Equity Loan Trust, 2004-E 2A	0.421%	6/15/29	8,287	8,019 (a)
Countrywide Home Equity Loan Trust, 2004-L 2A	0.441%	2/15/34	124,926	106,222 (a)(c)
Countrywide Home Equity Loan Trust, 2005-E 2A	0.381%	11/15/35	205,635	178,394 (a)(c)
Countrywide Home Loans, 2004-16 1A3A	0.930%	9/25/34	1,439,553	1,316,651 (a)(c)
Countrywide Home Loans, 2005-11 3A3	2.435%	4/25/35	896,298	681,574 (a)(c)
Countrywide Home Loans, 2005-11 6A1	0.770%	3/25/35	79,498	71,855 (a)(c)
Countrywide Home Loans, 2005-18 A7	19.059%	10/25/35	44,941	58,471 (a)(c)
Countrywide Home Loans, 2005-HYB7 1A1	2.930%	11/20/35	1,078,063	923,893 (a)(c)
Countrywide Home Loans, 2005-HYB9 1A1	2.319%	2/20/36	308,172	258,473 (a)(c)
Countrywide Home Loans, 2005-R2 1AF2	0.510%	6/25/35	1,289,810	895,970 (a)(b)
Countrywide Home Loans, 2006-HYB4 3B	2.540%	6/20/36	1,558,183	1,299,228 (a)(c)
Countrywide Home Loans Mortgage Pass-Through Trust, 2004-23 A	2.389%	11/25/34	328,981	281,729 (a)(c)
Countrywide Home Loans Mortgage Pass-Through Trust, 2005-02 2A1	0.490%	3/25/35	145,348	139,786 (a)(c)
Countrywide Home Loans Mortgage Pass-Through Trust, 2005-07 2A1	0.790%	3/25/35	328,535	304,979 (a)(c)
Countrywide Home Loans Mortgage Pass-Through Trust, 2005-09 1A1	0.470%	5/25/35	190,282	164,368 (a)(c)
Countrywide Home Loans Mortgage Pass-Through Trust, 2005-HY10 1A1	2.941%	2/20/36	346,176	293,757 (a)(c)
Countrywide Home Loans Mortgage Pass-Through Trust, 2005-HYB6 1A1	2.388%	10/20/35	1,255,141	1,001,686 (a)(c)
Countrywide Home Loans Mortgage Pass-Through Trust, 2005-R1 1AF1	0.530%	3/25/35	693,752	624,260 (a)(b)
Countrywide Home Loans Mortgage Pass-Through Trust, 2005-R2 2A3	8.000%	6/25/35	153,105	160,679 (b)
Countrywide Home Loans Mortgage Pass-Through Trust, 2006-3 2A1	0.420%	3/25/36	696,131	615,803 (a)(c)

See Notes to Financial Statements.

## Schedule of investments (cont d)

December 31, 2014

### Western Asset Mortgage Defined Opportunity Fund Inc.

Security	Rate	Maturity Date	Face Amount	Value
<b>Residential Mortgage-Backed Securities continued</b>				
Credit Suisse First Boston Mortgage Securities Corp., 2005-10 03A3	5.500%	11/25/35	733,726	\$ 647,215 (c)
Credit Suisse Mortgage Capital Certificates, 2006-8 2A1	5.500%	10/25/21	1,062,277	1,027,548 (c)
Credit Suisse Mortgage Capital Certificates, 2009-05R 2A3	2.218%	7/26/49	4,000,000	3,171,108 (a)(b)(c)
Credit Suisse Mortgage Capital Certificates, 2009-15R 2A2	5.556%	10/26/36	4,748,792	3,517,497 (a)(b)(c)
Credit-Based Asset Servicing and Securitization LLC, 2003-RP1 M1	1.720%	3/25/33	2,421,590	2,330,115 (a)(b)
Credit-Based Asset Servicing and Securitization LLC, 2006-SL1 A3	0.595%	9/25/36	4,746,395	1,023,966 (a)(b)
Deutsche ALT-A Securities Inc. Mortgage Loan Trust, 2006-AR1 2A1	2.867%	2/25/36	388,547	313,816 (a)(c)
Deutsche ALT-A Securities Inc. Mortgage Loan Trust, 2007-1 2A1	0.270%	8/25/37	520,749	384,517 (a)(c)
Deutsche Mortgage Securities Inc., 2006-PR1 2PO, PO	0.000%	4/15/36	89,292	81,724 (b)(c)
Deutsche Mortgage Securities Inc., 2006-PR1 4AS1, IO	8.870%	4/15/36	508,716	139,252 (a)(b)
Deutsche Mortgage Securities Inc., 2006-PR1 4AS2, IO	15.367%	4/15/36	486,645	226,318 (a)(b)
Deutsche Mortgage Securities Inc., 2006-PR1 5AS1, IO	10.715%	4/15/36	112,793	45,140 (a)(b)
Deutsche Mortgage Securities Inc., 2006-PR1 5AS3, IO	7.272%	4/15/36	416,113	126,287 (a)(b)
Downey Savings & Loan Association Mortgage Loan Trust, 2005-AR1 2A1B	0.484%	3/19/45	1,979,873	1,268,311 (a)(c)
Downey Savings & Loan Association Mortgage Loan Trust, 2005-AR2 2A1A	0.374%	3/19/45	511,093	456,378 (a)(c)
EMC Mortgage Loan Trust, 2002-AA A1	1.110%	5/25/39	148,120	142,344 (a)(b)
EMC Mortgage Loan Trust, 2006-A A1	0.620%	12/25/42	1,135,521	1,080,001 (a)(b)
Federal National Mortgage Association (FNMA), 2012-134, IO	5.981%	12/25/42	6,438,573	1,474,684 (a)(e)
First Horizon Alternative Mortgage Securities, 2005-AA6 3A1	2.200%	8/25/35	1,493,076	1,323,461 (a)(c)
First Horizon Alternative Mortgage Securities, 2006-FA6 2A1, PAC-11	6.250%	11/25/36	214,962	176,261 (c)
First Horizon Alternative Mortgage Securities, 2006-FA8 1A8	0.540%	2/25/37	471,617	273,705 (a)(c)
First Horizon Mortgage Pass-Through Trust, 2005-AR4 2A1	2.564%	10/25/35	875,857	773,007 (a)(c)
First Republic Mortgage Loan Trust, 2000-FRB2 A1	0.661%	11/15/30	283,095	254,707 (a)(c)
Fremont Home Loan Trust, 2006-B 2A2	0.270%	8/25/36	838,268	360,764 (a)
Fremont Home Loan Trust, 2006-B 2A4	0.410%	8/25/36	1,012,962	446,267 (a)
Government National Mortgage Association (GNMA), 2013-010 AI, IO	3.500%	1/20/43	3,898,248	854,094 (e)
Green Tree Mortgage Loan Trust, 2005-HE1 M6	1.520%	12/25/32	1,220,347	1,066,840 (a)(b)
Greenpoint Mortgage Funding Trust, 2006-AR3 4A1	0.380%	4/25/36	4,128,124	3,187,688 (a)(c)
GS Mortgage Securities Corp. II, 2000-1A A	0.866%	3/20/23	103,888	104,070 (a)(b)(c)
GSAA Home Equity Trust, 2005-11 2A2	0.490%	10/25/35	3,725,644	2,746,765 (a)(c)

See Notes to Financial Statements.

## Western Asset Mortgage Defined Opportunity Fund Inc.

Security	Rate	Maturity Date	Face Amount	Value
<b>Residential Mortgage-Backed Securities continued</b>				
GSAA Home Equity Trust, 2005-R1 1A2, IO	4.845%	4/25/35	4,411,412	\$ 467,610 (a)(b)
GSAMP Trust, 2004-SEA2 M2	1.420%	3/25/34	6,200,000	5,658,250 (a)
GSAMP Trust, 2007-FM1 A2C	0.340%	12/25/36	2,120,746	1,127,210 (a)(c)
GSAMP Trust, 2007-FM1 A2D	0.420%	12/25/36	3,502,310	1,898,536 (a)(c)
GSMPS Mortgage Loan Trust, 2001-2 A	7.500%	6/19/32	729,174	773,100 (a)(b)
GSMPS Mortgage Loan Trust, 2004-4 2A1	3.328%	6/25/34	287,935	270,148 (a)(b)
GSMPS Mortgage Loan Trust, 2005-LT1 A1	0.630%	2/25/35	202,551	190,336 (a)(b)(c)
GSMPS Mortgage Loan Trust, 2005-RP1 1A3	8.000%	1/25/35	174,407	185,965 (b)
GSMPS Mortgage Loan Trust, 2005-RP1 1A4	8.500%	1/25/35	116,717	127,103 (b)
GSMPS Mortgage Loan Trust, 2005-RP1 1AF	0.520%	1/25/35	349,845	295,723 (a)(b)(c)
GSMPS Mortgage Loan Trust, 2006-RP1 1A2	7.500%	1/25/36	664,466	672,738 (b)
GSMPS Mortgage Loan Trust, 2006-RP1 1A3	8.000%	1/25/36	120,377	126,072 (b)
GSR Mortgage Loan Trust, 2005-AR4 2A1	2.655%	7/25/35	495,112	445,443 (a)(c)
GSR Mortgage Loan Trust, 2005-AR5 1A1	2.767%	10/25/35	190,123	169,700 (a)(c)
GSR Mortgage Loan Trust, 2006-09F 5A2, IO	6.381%	10/25/36	927,336	160,365 (a)
GSR Mortgage Loan Trust, 2006-10F 4A2, IO	6.481%	1/25/37	1,788,252	421,978 (a)
GSRPM Mortgage Loan Trust, 2007-1 A	0.570%	10/25/46	2,342,578	1,963,872 (a)(b)
HarborView Mortgage Loan Trust, 2005-9 B5	1.166%	6/20/35	2,997,587	2,360,381 (a)
HarborView Mortgage Loan Trust, 2006-02	2.695%	2/25/36	65,640	52,911 (a)(c)
Home Equity Mortgage Trust, 2006-1 A3	0.655%	5/25/36	3,500,000	344,572 (a)
Homestar Mortgage Acceptance Corp., 2004-3 M3	1.770%	7/25/34	683,956	554,985 (a)(c)
Homestar Mortgage Acceptance Corp., 2004-6 M7	2.120%	1/25/35	1,132,859	917,965 (a)(c)
HSI Asset Loan Obligation Trust, 2007-AR1 4A1	4.923%	1/25/37	376,503	320,075 (a)(c)
IMC Home Equity Loan Trust, 1998-1 A5	7.450%	6/20/29	1,315,355	1,339,829
Impac CMB Trust, 2004-8 1A	0.890%	10/25/34	621,002	546,507 (a)(c)
IMPAC Secured Assets Corp., 2007-1 A2	0.330%	3/25/37	769,307	613,162 (a)(c)
Indymac Home Equity Loan Asset-Backed Trust, 2001-A	0.675%	3/25/31	113,585	94,251 (a)
Indymac INDA Mortgage Loan Trust, 2005-AR2 1A1	2.608%	1/25/36	174,237	161,734 (a)(c)
Indymac INDB Mortgage Loan Trust, 2005-1 A1	0.470%	11/25/35	1,978,914	1,197,336 (a)
Indymac Index Mortgage Loan Trust, 2004-AR13 1A1	2.461%	1/25/35	141,602	132,497 (a)(c)
Indymac Index Mortgage Loan Trust, 2004-AR15 1A1	2.735%	2/25/35	210,655	181,634 (a)(c)
Indymac Index Mortgage Loan Trust, 2005-AR15 A2	4.533%	9/25/35	154,159	134,278 (a)(c)
Indymac Index Mortgage Loan Trust, 2006-AR07 5A1	2.631%	5/25/36	604,662	490,651 (a)(c)
Indymac Index Mortgage Loan Trust, 2006-AR09 3A3	4.344%	6/25/36	892,363	852,178 (a)(c)
Indymac Index Mortgage Loan Trust, 2006-AR11 1A1	2.794%	6/25/36	600,823	457,332 (a)(c)
Indymac Index Mortgage Loan Trust, 2006-AR25 4A3	2.588%	9/25/36	2,654,758	1,634,943 (a)(c)
Indymac Index Mortgage Loan Trust, 2007-AR05 2A1	2.662%	5/25/37	2,887,447	2,273,972 (a)(c)
Indymac Index Mortgage Loan Trust, 2007-AR07 2A1	2.057%	6/25/37	329,653	252,943 (a)(c)

See Notes to Financial Statements.

## Schedule of investments (cont d)

December 31, 2014

### Western Asset Mortgage Defined Opportunity Fund Inc.

Security	Rate	Maturity Date	Face Amount	Value
<b>Residential Mortgage-Backed Securities continued</b>				
Indymac Index Mortgage Loan Trust, 2007-AR15 2A1	4.351%	8/25/37	337,850	\$ 286,055 (a)(c)
Irwin Home Equity, 2005-C 1M4	6.750%	4/25/30	608,152	583,366
Jefferies & Co., 2009-R2 5A	3.273%	1/26/36	1,543,006	1,432,734 (a)(b)(c)
Jefferies & Co., 2009-R6 6A2	2.605%	10/26/35	2,981,788	2,559,695 (a)(b)(c)
JPMorgan Alternative Loan Trust, 2006-A4 A7	3.751%	9/25/36	1,044,915	693,475 (a)(c)
JPMorgan Alternative Loan Trust, 2006-S1 3A4	6.180%	3/25/36	1,313,050	854,621 (a)(c)
JPMorgan Alternative Loan Trust, 2007-A1 3A1	2.532%	3/25/37	817,302	642,123 (a)
JPMorgan Mortgage Trust, 2005-A6 3A3	2.649%	9/25/35	1,100,000	1,050,462 (a)(c)
JPMorgan Mortgage Trust, 2005-S3 1A1	6.500%	1/25/36	1,495,164	1,299,617 (c)
JPMorgan Mortgage Trust, 2007-S2 3A2	6.000%	6/25/37	202,936	193,826 (c)
JPMorgan Mortgage Trust, 2007-S2 3A3	6.500%	6/25/37	65,399	64,485 (c)
JPMorgan Reremic, 2014-6 3A2	0.379%	7/27/46	1,729,604	937,316 (a)(b)
Lehman ABS Corp. Home Equity Loan Trust, 2004-2 A	0.610%	6/25/34	140,715	133,291 (a)
Lehman Mortgage Trust, 2006-3 1A7, IO	5.231%	7/25/36	11,282,115	1,961,678 (a)
Lehman Mortgage Trust, 2006-3 2A1	0.530%	7/25/36	4,356,480	1,560,759 (a)
Lehman Mortgage Trust, 2006-3 2A2, IO	6.971%	7/25/36	4,923,389	1,589,836 (a)
Lehman Mortgage Trust, 2006-7 1A3, IO	5.181%	11/25/36	11,217,154	2,113,200 (a)
Lehman Mortgage Trust, 2006-7 3A2, IO	6.981%	11/25/36	8,149,792	2,831,050 (a)
Lehman Mortgage Trust, 2007-1 2A3, IO	6.461%	2/25/37	13,296,658	3,695,886 (a)
Lehman XS Trust, 2005-9N 1A1	0.440%	2/25/36	1,637,124	1,376,848 (a)(c)
Lehman XS Trust, 2006-14N 3A2	0.290%	8/25/36	3,294,159	2,565,777 (a)(c)
Lehman XS Trust, 2006-19 A4	0.340%	12/25/36	1,326,308	909,541 (a)(c)
Lehman XS Trust, 2007-4N 1A2A	0.330%	3/25/47	4,520,746	3,477,358 (a)(c)
Lehman XS Trust, 2007-8H A1	0.300%	6/25/37	96,338	84,105 (a)(c)
MASTR Adjustable Rate Mortgages Trust, 2004-12 5A1	7.053%	10/25/34	234,075	220,024 (a)(c)
MASTR Adjustable Rate Mortgages Trust, 2006-0A1 1A1	0.380%	4/25/46	427,627	325,932 (a)(c)
MASTR Adjustable Rate Mortgages Trust, 2006-2 4A1	2.628%	2/25/36	118,620	116,910 (a)(c)
MASTR Asset-Backed Securities Trust, 2005-AB1 A5A	5.712%	11/25/35	3,360,000	2,103,699
MASTR Asset-Backed Securities Trust, 2006-HE4 A3	0.320%	11/25/36	3,783,111	1,826,089 (a)
MASTR Reperforming Loan Trust, 2005-1 1A2	6.500%	8/25/34	993,044	1,016,730 (b)
MASTR Reperforming Loan Trust, 2005-1 1A3	7.000%	8/25/34	265,739	272,510 (b)
MASTR Reperforming Loan Trust, 2005-1 1A4	7.500%	8/25/34	112,053	115,126 (b)
MASTR Reperforming Loan Trust, 2005-2 1A3	7.500%	5/25/35	16,159	16,969 (b)
MASTR Reperforming Loan Trust, 2006-2 1A1	4.765%	5/25/36	1,946,442	1,848,608 (a)(b)
Merrill Lynch Mortgage Investors Trust, 2005-1 2A2	2.127%	4/25/35	151,433	147,590 (a)(c)
Merrill Lynch Mortgage Investors Trust, 2005-A2 A5	2.472%	2/25/35	528,574	531,198 (a)(c)
Merrill Lynch Mortgage Investors Trust, 2006-A1 2A1	3.094%	3/25/36	1,034,775	713,231 (a)(c)
Morgan Stanley Capital Inc., 2003-NC10 M2	2.870%	10/25/33	609,509	569,922 (a)

See Notes to Financial Statements.

## Western Asset Mortgage Defined Opportunity Fund Inc.

Security	Rate	Maturity Date	Face Amount	Value
<b>Residential Mortgage-Backed Securities continued</b>				
Morgan Stanley Mortgage Loan Trust, 2004-6AR 2A2	2.622%	8/25/34	566,498	\$ 560,894 (a)(c)
Morgan Stanley Mortgage Loan Trust, 2004-7AR B1	2.402%	9/25/34	607,916	301,488 (a)
Morgan Stanley Mortgage Loan Trust, 2005-5AR 4A1	5.198%	9/25/35	4,023,909	3,132,291 (a)(c)
Morgan Stanley Mortgage Loan Trust, 2006-1AR 1AX, IO	3.496%	2/25/36	6,165,638	604,676 (a)
Morgan Stanley Mortgage Loan Trust, 2006-3AR 1A3	0.430%	3/25/36	1,930,509	1,487,607 (a)(c)
Morgan Stanley Mortgage Loan Trust, 2006-8AR 1A2	0.240%	6/25/36	353,747	190,526 (a)(c)
Morgan Stanley Mortgage Loan Trust, 2007-05AX 2A3	0.400%	2/25/37	1,627,684	979,660 (a)(c)
Morgan Stanley Mortgage Loan Trust, 2007-15AR 4A1	4.710%	11/25/37	1,659,997	1,265,298 (a)(c)
New Century Home Equity Loan Trust, 2004-3 M3	1.235%	11/25/34	1,121,062	971,449 (a)
Nomura Asset Acceptance Corp., 2004-R3 B2	6.766%	2/25/35	571,292	6 (b)
Nomura Resecuritization Trust, 2010-4RA 1A2	2.414%	8/26/34	2,900,000	2,422,625 (a)(b)(c)
Nomura Resecuritization Trust, 2014-5R 1A9	13.307%	6/26/35	1,884,830	1,913,103 (a)(b)(c)
Popular ABS Mortgage Pass-Through Trust, 2004-4 M2	5.626%	9/25/34	1,521,035	1,387,030
Popular ABS Mortgage Pass-Through Trust, 2006-D A3	0.430%	11/25/46	2,450,000	2,145,098 (a)
Prime Mortgage Trust, 2006-DR1 2A1	5.500%	5/25/35	3,443,415	3,468,287 (b)(c)
Provident Bank Home Equity Loan Trust, 2000-2 A1	0.710%	8/25/31	1,637,509	1,421,587 (a)
RAAC, 2007-RP3 A	0.550%	10/25/46	2,157,035	1,921,635 (a)(b)
RAAC Series, 2006-RP3 A	0.440%	5/25/36	738,190	661,420 (a)(b)
RAAC Series, 2007-RP2 A	0.870%	2/25/46	1,186,525	1,086,233 (a)(b)
Renaissance Home Equity Loan Trust, 2004-3 M1	5.157%	11/25/34	1,068,399	993,412
Renaissance Home Equity Loan Trust, 2006-1 AF5	6.166%	5/25/36	640,000	474,896
Renaissance Home Equity Loan Trust, 2006-2 AV3	0.410%	8/25/36	1,545,161	866,382 (a)
Renaissance Home Equity Loan Trust, 2007-1 AF3	5.612%	4/25/37	6,445,744	3,500,639
Renaissance Home Equity Loan Trust, 2007-2 AF1	5.893%	6/25/37	2,651,472	1,447,836
Renaissance Home Equity Loan Trust, 2007-2 AF2	5.675%	6/25/37	456,928	241,148
Renaissance Home Equity Loan Trust, 2007-2 AF5	6.203%	6/25/37	1,965,282	1,131,313
Renaissance Home Equity Loan Trust, 2007-2 AF6	5.879%	6/25/37	3,305,799	1,801,208
Renaissance Home Equity Loan Trust, 2007-3 AF3	7.238%	9/25/37	1,741,392	1,139,078
Residential Accredit Loans Inc., 2005-QA3 CB4	3.308%	3/25/35	3,023,980	2,048,838 (a)(c)
Residential Accredit Loans Inc., 2006-QA01 A11	3.238%	1/25/36	892,541	703,208 (a)(c)
Residential Accredit Loans Inc., 2006-QA01 A31	4.369%	1/25/36	2,172,552	1,678,271 (a)(c)
Residential Accredit Loans Inc., 2006-QA04 A	0.350%	5/25/36	576,787	468,606 (a)(c)
Residential Accredit Loans Inc., 2006-QA10 A2	0.350%	12/25/36	1,070,697	827,526 (a)(c)
Residential Accredit Loans Inc., 2006-QO1 3A1	0.440%	2/25/46	4,067,957	2,547,196 (a)(c)
Residential Accredit Loans Inc., 2006-QO2 A2	0.440%	2/25/46	5,247,588	2,602,827 (a)(c)
Residential Accredit Loans Inc., 2006-QS13 1A2, IO	6.991%	9/25/36	1,181,263	270,030 (a)
Residential Accredit Loans Inc., 2007-QA2 A1	0.300%	2/25/37	582,224	494,743 (a)(c)
Residential Accredit Loans Inc., 2007-QS1 2A1, IO	6.471%	1/25/37	5,509,508	1,118,122 (a)

See Notes to Financial Statements.

## Schedule of investments (cont d)

December 31, 2014

## Western Asset Mortgage Defined Opportunity Fund Inc.

Security	Rate	Maturity Date	Face Amount	Value
<b>Residential Mortgage-Backed Securities continued</b>				
Residential Asset Mortgage Products Inc., 2002-RS4 AII	0.810%	8/25/32	304,407	\$ 283,879 (a)
Residential Asset Mortgage Products Inc., 2004-RZ4 M7	2.670%	12/25/34	275,812	238,279 (a)(c)
Residential Asset Mortgage Products Inc., 2004-SL3 A3	7.500%	12/25/31	1,016,757	1,068,901
Residential Asset Mortgage Products Inc., 2004-SL3 A4	8.500%	12/25/31	131,782	121,236
Residential Asset Mortgage Products Inc., 2005-SL2 A5	8.000%	10/25/31	342,341	347,522
Residential Asset Securities Corp., 2003-KS9 A2B	0.795%	11/25/33	1,109,005	941,590 (a)
Residential Asset Securitization Trust, 2005-A13 1A3	0.640%	10/25/35	264,193	201,931 (a)(c)
Residential Asset Securitization Trust, 2005-A7 A2, IO	7.081%	6/25/35	3,604,536	753,703 (a)
Residential Asset Securitization Trust, 2006-A1 1A6	0.670%	4/25/36	2,643,142	1,721,450 (a)(c)
Residential Asset Securitization Trust, 2006-A1 1A7, IO	5.331%	4/25/36	5,517,894	892,919 (a)
Residential Asset Securitization Trust, 2007-A1 A6, IO	6.887%	3/25/37	6,260,583	1,793,225 (a)
Residential Asset Securitization Trust, 2007-A2 1A1	6.000%	4/25/37	473,876	412,463 (c)
Residential Funding Mortgage Securities I, 2005-SA3 1A	2.723%	8/25/35	4,387,339	3,538,213 (a)(c)
Residential Funding Mortgage Securities I, 2006-SA2 4A1	5.811%	8/25/36	562,845	508,893 (a)(c)
Residential Funding Mortgage Securities II, 2005-HI2 M7	5.810%	5/25/35	674,718	675,831 (c)
Residential Funding Mortgage Securities II Inc., 2004-HS1 AI6	3.640%	3/25/34	76,723	76,837 (a)(c)
Saxon Asset Securities Trust, 2007-3 2A1	0.390%	9/25/47	954,656	928,004 (a)
Structured ARM Loan Trust, 2004-07 A3	0.905%	6/25/34	215,387	202,688 (a)(c)
Structured ARM Loan Trust, 2004-16 1A2	2.462%	11/25/34	746,096	737,556 (a)(c)
Structured ARM Loan Trust, 2004-18 1A2	2.484%	12/25/34	777,233	751,527 (a)(c)
Structured ARM Loan Trust, 2005-04 1A1	2.439%	3/25/35	339,332	306,274 (a)(c)
Structured ARM Loan Trust, 2005-04 5A	4.424%	3/25/35	291,231	266,628 (a)(c)
Structured ARM Loan Trust, 2005-07 1A3	2.467%	4/25/35	177,677	171,164 (a)(c)
Structured ARM Loan Trust, 2005-12 3A1	2.404%	6/25/35	198,112	186,418 (a)(c)
Structured ARM Loan Trust, 2005-20 4A2	5.365%	10/25/35	1,314,951	115,621 (a)
Structured ARM Loan Trust, 2006-4 4A1	4.956%	5/25/36	477,558	363,014 (a)(c)
Structured ARM Loan Trust, 2006-8 3A5	4.333%	9/25/36	2,271,923	1,797,459 (a)(c)
Structured ARM Loan Trust, 2007-5 2A2	2.486%	6/25/37	1,117,754	657,673 (a)(c)
Structured ARM Loan Trust, 2007-7 1A1	0.470%	8/25/37	1,911,718	1,646,781 (a)(c)
Structured Asset Investment Loan Trust, 2004-8 M7	2.945%	9/25/34	104,650	87,641 (a)
Structured Asset Investment Loan Trust, 2004-8 M9	3.920%	9/25/34	318,981	87,879 (a)
Structured Asset Mortgage Investments Inc., 2006-AR5 4A1	0.390%	5/25/46	784,954	448,825 (a)(c)
Structured Asset Securities Corp., 1999-RF1 A	5.969%	10/15/28	853,678	810,861 (a)(b)
Structured Asset Securities Corp., 2004-20 5A1	6.250%	11/25/34	267,133	275,661 (c)
Structured Asset Securities Corp., 2005-4XS 3M3	5.079%	3/25/35	1,066,256	11
Structured Asset Securities Corp., 2005-5 2A2	5.500%	4/25/35	326,770	326,456 (c)
Structured Asset Securities Corp., 2005-RF1 A	0.520%	3/25/35	102,128	86,453 (a)(b)(c)
Structured Asset Securities Corp., 2006-RF3 1A1, PAC-11	6.000%	10/25/36	1,464,286	1,471,382 (b)

See Notes to Financial Statements.



## Western Asset Mortgage Defined Opportunity Fund Inc.

Security	Rate	Maturity Date	Face Amount	Value
<b>Residential Mortgage-Backed Securities continued</b>				
Structured Asset Securities Corp., 2006-RF4 2A2	6.000%	10/25/36	2,388,337	\$ 1,000,156 (b)
Voyager Countywide Delaware Trust, 2009-1 3QB1, IO	0.411%	3/16/30	1,101,513	946,659 (a)(b)(c)
Wachovia Mortgage Loan Trust LLC, 2005-B 2A2	2.476%	10/20/35	82,831	77,784 (a)(c)
Wachovia Mortgage Loan Trust LLC, 2006-ALT1 A2	0.335%	1/25/37	798,396	592,337 (a)(c)
WaMu Mortgage Pass-Through Certificates, 2004-AR10 A3	0.720%	7/25/44	117,443	109,950 (a)(c)
WaMu Mortgage Pass-Through Certificates, 2005-09 5A4	34.690%	11/25/35	152,358	219,047 (a)(c)
WaMu Mortgage Pass-Through Certificates, 2005-10 2A3	1.070%	11/25/35	280,316	206,722 (a)(c)
WaMu Mortgage Pass-Through Certificates, 2005-AR05 A6	2.369%	5/25/35	540,873	540,603 (a)(c)
WaMu Mortgage Pass-Through Certificates, 2005-AR13 A1C3	0.660%	10/25/45	510,523	430,669 (a)(c)
WaMu Mortgage Pass-Through Certificates, 2005-AR18 2A1	2.502%	1/25/36	831,964	741,213 (a)(c)
WaMu Mortgage Pass-Through Certificates, 2006-AR10 A1	0.270%	12/25/36	703,544	478,985 (a)(c)
WaMu Mortgage Pass-Through Certificates, 2006-AR15 2A1B	2.163%	11/25/46	953,410	502,710 (a)(c)
WaMu Mortgage Pass-Through Certificates, 2006-AR16 2A2	2.010%	12/25/36	468,579	407,783 (a)(c)
WaMu Mortgage Pass-Through Certificates, 2006-AR18 1A1	1.822%	1/25/37	57,214	48,947 (a)(c)
WaMu Mortgage Pass-Through Certificates, 2007-HY3 4A1	2.353%	3/25/37	193,816	184,513 (a)(c)
WaMu Mortgage Pass-Through Certificates, 2007-HY7 1A1	2.329%	7/25/37	205,561	167,457 (a)(c)
WaMu Mortgage Pass-Through Certificates, 2007-HY7 3A1	2.346%	7/25/37	346,285	311,451 (a)(c)
WaMu Mortgage Pass-Through Certificates, 2007-OA2 2A	1.913%	3/25/47	2,734,725	2,229,074 (a)(c)
WaMu Mortgage Pass-Through Certificates, 2007-OA3 2A	0.883%	4/25/47	1,332,367	1,084,211 (a)(c)
Wells Fargo Alternative Loan Trust, 2007-PA1 A12, IO	5.291%	3/25/37	7,692,956	1,251,732 (a)(f)
Wells Fargo Mortgage Backed Securities Trust, 2005-AR2 2A2	2.613%	3/25/35	187,972	191,824 (a)(c)
Wells Fargo Mortgage-Backed Securities Trust, 2006-AR8 3A2	2.601%	4/25/36	64,022	62,140 (a)(c)
<b>Total Residential Mortgage-Backed Securities (Cost \$267,832,561)</b>				<b>297,131,595</b>

See Notes to Financial Statements.

## Schedule of investments (cont d)

December 31, 2014

## Western Asset Mortgage Defined Opportunity Fund Inc.

Security	Rate	Maturity Date	Face Amount /	
			Units	Value
<b>Asset-Backed Securities 11.7%</b>				
Bombardier Capital Mortgage Securitization Corp. Trust, 1998-B A	6.530%	10/15/28	1,017,543	\$ 1,065,684 (a)
Bombardier Capital Mortgage Securitization Corp. Trust, 1999-A A3	5.980%	1/15/18	568,192	591,273 (a)
Bombardier Capital Mortgage Securitization Corp. Trust, 1999-A A4	6.475%	11/15/25	3,042,561	3,220,230 (a)
Credit-Based Asset Servicing and Securitization LLC, 2006-MH1 M1	5.453%	10/25/36	500,000	543,854 (b)
Firstfed Corp. Manufactured Housing Contract, 1997-2 B	8.110%	5/15/24	530,000	571,666 (b)
Greenpoint Manufactured Housing, 1999-3 1A7	7.270%	6/15/29	1,287,488	1,299,974 (c)
Greenpoint Manufactured Housing, 1999-3 2A2	3.520%	6/19/29	625,000	543,750 (a)(c)
Greenpoint Manufactured Housing, 1999-4 A2	3.655%	2/20/30	900,000	783,000 (a)(c)
Greenpoint Manufactured Housing, 2000-4 A3	2.155%	8/21/31	25,000	23,785 (a)(c)
Greenpoint Manufactured Housing, 2001-2 IA2	3.657%	2/20/32	650,000	600,684 (a)
Greenpoint Manufactured Housing, 2001-2 IIA2	3.653%	3/13/32	900,000	820,400 (a)
Magnus Relda Holding Vier GmbH, 1A JNR	7.000%	10/28/24	1,100,000 EUR	1,344,366 (b)(d)
Oakwood Mortgage Investors Inc., 2001-E A2	5.050%	12/15/31	3,298,082	3,007,973
Origen Manufactured Housing, 2006-A A2	2.645%	10/15/37	2,462,720	2,225,412 (a)(c)
Origen Manufactured Housing, 2007-A A2	2.497%	4/15/37	2,589,917	2,313,388 (a)(c)
Park Place Securities Inc., 2004-WHQ2 M5	1.895%	2/25/35	3,070,364	2,350,815 (a)
SMB Private Education Loan Trust, 2014-A C	4.500%	9/15/45	2,880,000	2,304,000 (b)
SMB Private Education Loan Trust, 2014-A R	0.000%	9/15/45	6,875	3,002,869 (b)(d)(f)
Social Professional Loan Program LLC, 2014-A RC	0.000%	7/14/24	700	3,500,000 (b)(d)(f)
<b>Total Asset-Backed Securities (Cost \$28,218,773)</b>				<b>30,113,123</b>
<b>Commercial Mortgage-Backed Securities 20.6%</b>				
Banc of America Commercial Mortgage Trust, 2007-2 AJ	5.622%	4/10/49	3,000,000	2,981,141 (a)
Bank of America Merrill Lynch Large Loan Inc., 2014-INMZ MZB	8.644%	12/15/19	1,500,000	1,500,586 (a)(b)(d)
BLCP Hotel Trust, 2014-CLMZ M	5.889%	8/15/29	1,500,000	1,491,995 (a)(b)
Carefree Portfolio Trust, 2014-CMZB MZB	7.883%	11/15/29	4,000,000	4,004,966 (a)(b)
CD Commercial Mortgage Trust, 2007-CD4 AJ	5.398%	12/11/49	1,130,000	947,985 (a)
COBALT CMBS Commercial Mortgage Trust, 2007-C3 AJ	5.766%	5/15/46	830,000	857,139 (a)
COMM Mortgage Trust, 2006-C8 AJ	5.377%	12/10/46	1,550,000	1,580,958
COMM Mortgage Trust, 2013-CR12 E	5.085%	10/10/46	110,000	98,801 (a)(b)
COMM Mortgage Trust, 2013-CR13 E	4.756%	12/10/23	100,000	87,943 (a)(b)
Credit Suisse Commercial Mortgage Trust, 2006-C5 AJ	5.373%	12/15/39	411,000	397,461

See Notes to Financial Statements.

## Western Asset Mortgage Defined Opportunity Fund Inc.

Security	Rate	Maturity Date	Face Amount	Value
<b>Commercial Mortgage-Backed Securities continued</b>				
Credit Suisse Commercial Mortgage Trust, 2007-C2 AJ	5.607%	1/15/49	820,000	\$ 830,406 (a)
Credit Suisse European Mortgage Capital Trust, 2014-1MGN B	7.165%	7/20/22	1,500,000 EUR	1,815,075 (a)(b)
Credit Suisse Mortgage Trust, 2014-TIKI F	3.993%	9/15/38	2,500,000	2,481,250 (a)(b)
Credit Suisse Mortgage Trust, 2014-USA F	4.373%	9/15/37	1,620,000	1,399,052 (b)
Federal Home Loan Mortgage Corp. (FHLMC), Multi-Family Structured Pass-Through Certificates, K007 X1, IO	1.186%	4/25/20	1,872,071	86,264 (a)(c)
Federal Home Loan Mortgage Corp. (FHLMC), Multi-Family Structured Pass-Through Certificates, K008 X1, IO	1.654%	6/25/20	833,394	56,522 (a)(c)
Federal Home Loan Mortgage Corp. (FHLMC), Multi-Family Structured Pass-Through Certificates, K034 X3, IO	1.726%	9/25/41	10,200,000	1,230,742 (a)(c)
FREMF Mortgage Trust, 2014-KF04 B	3.420%	6/25/21	1,996,618	2,000,513 (a)(b)
FREMF Mortgage Trust, 2014-KF05 B	4.156%	9/25/22	2,156,763	2,162,280 (a)(b)
GE Business Loan Trust, 2005-1A D	2.881%	6/15/33	1,287,524	1,245,435 (a)(b)
GMAC Commercial Mortgage Securities Inc., 2006-C1 AJ	5.349%	11/10/45	2,000,000	1,954,642 (a)
GS Mortgage Securities Corp., 2010-C1 X, IO	1.502%	8/10/43	14,794,815	950,981 (a)(b)(c)
GS Mortgage Securities Trust, 2006-GG8 AJ	5.622%	11/10/39	190,000	195,192
GS Mortgage Securities Trust, 2013-GC14 F	4.772%	8/10/46	160,000	137,727 (a)(b)
Hyatt Hotel Portfolio Trust, 2014-HYMZ M	6.386%	11/15/16	1,750,000	1,750,766 (a)(b)
JPMorgan Chase Commercial Mortgage Securities Trust, 2006-CB16 AJ	5.623%	5/12/45	380,000	390,041
JPMorgan Chase Commercial Mortgage Securities Trust, 2006-LDP7 AJ	5.865%	4/15/45	940,000	937,864 (a)
JPMorgan Chase Commercial Mortgage Securities Trust, 2006-LDP9 AJ	5.411%	5/15/47	2,290,000	1,952,798
JPMorgan Chase Commercial Mortgage Securities Trust, 2006-LDP9 AJS	5.386%	5/15/47	420,000	367,127 (a)
JPMorgan Chase Commercial Mortgage Securities Trust, 2007-CB18 AJ	5.502%	6/12/47	660,000	659,935 (a)
JPMorgan Chase Commercial Mortgage Securities Trust, 2014-CBMZ M	6.386%	10/15/19	1,900,000	1,906,380 (a)(b)
LB-UBS Commercial Mortgage Trust, 2007-C6 AJ	6.125%	7/15/40	1,305,000	1,345,833 (a)
ML-CFC Commercial Mortgage Trust, 2007-5 AJ	5.450%	8/12/48	412,000	401,652 (a)
ML-CFC Commercial Mortgage Trust, 2007-9 AJ	6.193%	9/12/49	1,422,000	1,396,404 (a)
ML-CFC Commercial Mortgage Trust, 2007-9 AJA	6.217%	9/12/49	400,000	393,523 (a)
Morgan Stanley Bank of America Merrill Lynch Trust, 2013-C10 G	4.083%	7/15/46	100,000	82,340 (a)(b)
UBS-Barclays Commercial Mortgage Trust, 2012-C2 G	4.890%	5/10/63	3,130,000	2,064,333 (a)(b)(d)
UBS-Barclays Commercial Mortgage Trust, 2012-C2 H	5.000%	5/10/63	5,510,000	1,934,563 (a)(b)(d)
Wells Fargo Commercial Mortgage Trust, 2013-LC12 E	3.500%	7/15/46	130,000	101,319 (b)

See Notes to Financial Statements.

## Schedule of investments (cont d)

December 31, 2014

### Western Asset Mortgage Defined Opportunity Fund Inc.

Security	Rate	Maturity Date	Face Amount	Value
<b>Commercial Mortgage-Backed Securities – continued</b>				
WF-RBS Commercial Mortgage Trust, 2011-C4 F	5.000%	6/15/44	3,870,000	\$ 3,643,245 (a)(b)
WF-RBS Commercial Mortgage Trust, 2012-C9 E	4.803%	11/15/45	3,500,000	3,126,879 (a)(b)
<b>Total Commercial Mortgage-Backed Securities (Cost \$52,463,879)</b>				<b>52,950,058</b>
<b>Corporate Bonds &amp; Notes 8.5%</b>				
<b>Consumer Discretionary 1.2%</b>				
<i>Household Durables 1.2%</i>				
William Lyon Homes Inc., Senior Notes	8.500%	11/15/20	3,000,000	<b>3,247,500</b> (e)
<b>Consumer Staples 0.2%</b>				
<i>Food &amp; Staples Retailing 0.2%</i>				
CVS Corp., Pass-Through Trust	9.350%	1/10/23	480,000	<b>574,693</b> (b)(c)
<b>Industrials 1.5%</b>				
<i>Airlines 0.9%</i>				
Air 2 US, Notes	8.027%	10/1/19	120,304	128,726 (b)(c)
American Airlines, Pass-Through Trust, Secured Bonds	5.625%	1/15/21	1,140,127	1,168,630 (b)(c)
United Airlines Inc., Pass-Through Certificates, Notes	5.500%	10/29/20	905,981	937,691 (c)
<i>Total Airlines</i>				<i>2,235,047</i>
<i>Trading Companies &amp; Distributors 0.6%</i>				
Noble Group Ltd., Senior Notes	6.750%	1/29/20	1,400,000	<i>1,567,860</i> (e)(g)
<b>Total Industrials</b>				<b>3,802,907</b>
<b>Materials 4.6%</b>				
<i>Construction Materials 1.1%</i>				
Cemex Finance LLC, Senior Secured Notes	9.375%	10/12/22	2,560,000	<i>2,867,200</i> (b)(e)
<i>Metals &amp; Mining 3.5%</i>				
Evrax Group SA, Notes	6.750%	4/27/18	2,800,000	2,348,500 (b)(e)
Southern Copper Corp., Senior Notes	5.250%	11/8/42	3,000,000	2,695,038 (e)
Vale Overseas Ltd., Notes	8.250%	1/17/34	2,100,000	2,534,154 (e)
Vedanta Resources PLC, Senior Bonds	8.250%	6/7/21	1,350,000	1,342,406 (e)(g)
<i>Total Metals &amp; Mining</i>				<i>8,920,098</i>
<b>Total Materials</b>				<b>11,787,298</b>
<b>Telecommunication Services 1.0%</b>				
<i>Wireless Telecommunication Services 1.0%</i>				
Digicel Group Ltd., Senior Notes	8.250%	9/30/20	2,650,000	<b>2,583,750</b> (e)(g)
<b>Total Corporate Bonds &amp; Notes (Cost \$23,103,393)</b>				<b>21,996,148</b>
<b>Total Investments before Short-Term Investments (Cost \$371,618,606)</b>				<b>402,190,924</b>

See Notes to Financial Statements.

**Western Asset Mortgage Defined Opportunity Fund Inc.**

Security	Rate	Maturity Date	Face Amount	Value
<b>Short-Term Investments</b> 0.3%				
<i>Repurchase Agreements</i> 0.3%				
State Street Bank & Trust Co. repurchase agreement dated 12/31/14; Proceeds at maturity \$743,000; (Fully collateralized by U.S. government agency obligations, 2.000% due 1/30/23; Market value \$760,850)				
(Cost \$743,000)	0.000%	1/2/15	743,000	\$ 743,000
<b>Total Investments</b> 156.4% (Cost \$372,361,606#)				<b>402,933,924</b>
Liabilities in Excess of Other Assets (56.4)%				(145,312,734)
<b>Total Net Assets</b> 100.0%				<b>\$ 257,621,190</b>

Face amount denominated in U.S. dollars, unless otherwise noted.

- (a) Variable rate security. Interest rate disclosed is as of the most recent information available.
- (b) Security is exempt from registration under Rule 144A of the Securities Act of 1933. This security may be resold in transactions that are exempt from registration, normally to qualified institutional buyers. This security has been deemed liquid pursuant to guidelines approved by the Board of Directors, unless otherwise noted.
- (c) All or a portion of this security is pledged as collateral pursuant to the loan agreement (See Note 6).
- (d) Security is valued in good faith in accordance with procedures approved by the Board of Directors (See Note 1).
- (e) All or a portion of this security is held by the counterparty as collateral for open reverse repurchase agreements.
- (f) Illiquid security (unaudited).
- (g) Security is exempt from registration under Regulation S of the Securities Act of 1933. Regulation S applies to securities offerings that are made outside of the United States and do not involve direct selling efforts in the United States. This security has been deemed liquid pursuant to guidelines approved by the Board of Directors, unless otherwise noted.

# Aggregate cost for federal income tax purposes is \$354,182,071.

**Abbreviations used in this schedule:**

ARM	Adjustable Rate Mortgage
EUR	Euro
IO	Interest Only
PAC	Planned Amortization Class
PO	Principal Only

See Notes to Financial Statements.

## Statement of assets and liabilities

December 31, 2014

**ASSETS:**

Investments in securities, at value (Cost \$372,361,606)	\$ 402,933,924
Cash	2,617,629
Interest receivable	1,651,205
Deposits with brokers for open reverse repurchase agreements (Note 3)	475,000
Receivable for securities sold	57,783
Unrealized appreciation on forward foreign currency contracts	45,179
Deposits with brokers for open futures contracts	35,006
Principal paydown receivable	32,518
Prepaid expenses	7,065
<b>Total Assets</b>	<b>407,855,309</b>

**LIABILITIES:**

Loan payable (Note 6)	116,700,000
Payable for open reverse repurchase agreements (Note 3)	17,677,423
Distributions payable	12,660,376
Payable for securities purchased	1,829,525
Investment management fee payable	342,998
Interest payable (Notes 3 and 6)	202,629
Directors' fees payable	5,754
Payable to broker - variation margin on open futures contracts	4,625
Accrued expenses	810,789
<b>Total Liabilities</b>	<b>150,234,119</b>
<b>Total Net Assets</b>	<b>\$ 257,621,190</b>

**NET ASSETS:**

Par value (\$0.001 par value; 10,410,638 shares issued and outstanding; 100,000,000 shares authorized)	\$ 10,411
Paid-in capital in excess of par value	197,137,843
Undistributed net investment income	6,234,660
Accumulated net realized gain on investments, futures contracts, swap contracts and foreign currency transactions	23,634,836
Net unrealized appreciation on investments, futures contracts and foreign currencies	30,603,440
<b>Total Net Assets</b>	<b>\$ 257,621,190</b>
Shares Outstanding	10,410,638
Net Asset Value	\$24.75

See Notes to Financial Statements.

## Statement of operations

For the Year Ended December 31, 2014

<b>Investment Income:</b>	
<i>Interest</i>	<b>\$ 25,710,454</b>
<b>Expenses:</b>	
Investment management fee (Note 2)	3,962,421
Interest expense (Notes 3 and 6)	1,324,074
Excise tax (Note 1)	511,448
Audit and tax fees	208,840
Directors' fees	46,746
Legal fees	36,000
Shareholder reports	30,077
Transfer agent fees	29,722
Fund accounting fees	26,496
Stock exchange listing fees	24,856
Commitment fees (Note 6)	10,443
Custody fees	5,998
Insurance	5,880
Miscellaneous expenses	11,035
<i>Total Expenses</i>	<b>6,234,036</b>
<b>Net Investment Income</b>	<b>19,476,418</b>
<b>Realized and Unrealized Gain (Loss) on Investments, Futures Contracts, Swap Contracts and Foreign Currency Transactions (Notes 1, 3 and 4):</b>	
Net Realized Gain (Loss) From:	
Investment transactions	21,090,500
Futures contracts	(12,856)
Swap contracts	(604,544)
Foreign currency transactions	15,258
<i>Net Realized Gain</i>	<b>20,488,358</b>
Change in Net Unrealized Appreciation (Depreciation) From:	
Investment transactions	1,764,150
Futures contracts	(27,661)
Swap contracts	452,099
Foreign currencies	44,747
<i>Change in Net Unrealized Appreciation (Depreciation)</i>	<b>2,233,335</b>
<b>Net Gain on Investments, Futures Contracts, Swap Contracts and Foreign Currency Transactions</b>	<b>22,721,693</b>
<b>Increase in Net Assets From Operations</b>	<b>\$ 42,198,111</b>

See Notes to Financial Statements.

## Statements of changes in net assets

For the Years Ended December 31,	2014	2013
<b>Operations:</b>		
Net investment income	\$ 19,476,418	\$ 15,012,336
Net realized gain	20,488,358	15,892,622
Change in net unrealized appreciation (depreciation)	2,233,335	6,495,802
<i>Increase in Net Assets from Operations</i>	<i>42,198,111</i>	<i>37,400,760</i>
<b>Distributions to Shareholders From (Note 1):</b>		
Net investment income	(18,219,657)	(16,888,488)
Net realized gains	(13,908,612)	(21,618,730)
<i>Decrease in Net Assets from Distributions to Shareholders</i>	<i>(32,128,269)</i>	<i>(38,507,218)</i>
<b>Fund Share Transactions:</b>		
Reinvestment of distributions (0 and 10,423 shares issued, respectively)		251,154
<i>Increase in Net Assets from Fund Share Transactions</i>		<i>251,154</i>
<i>Increase (Decrease) in Net Assets</i>	<i>10,069,842</i>	<i>(855,304)</i>
<b>Net Assets:</b>		
Beginning of year	247,551,348	248,406,652
<b>End of year*</b>	<b>\$ 257,621,190</b>	<b>\$ 247,551,348</b>
*Includes undistributed net investment income of:	\$6,234,660	\$4,494,109

See Notes to Financial Statements.



## Statement of cash flows

For the Year Ended December 31, 2014

### Increase (Decrease) in Cash:

#### Cash Provided (Used) by Operating Activities:

Net increase in net assets resulting from operations	\$ 42,198,111
Adjustments to reconcile net increase in net assets resulting from operations to net cash provided (used) by operating activities:	
Purchases of portfolio securities	(138,229,458)
Sales of portfolio securities	143,580,213
Net purchases, sales and maturities of short-term investments	(743,000)
Net amortization of premium (accretion of discount)	(2,998,027)
Increase in receivable for securities sold	(7,783)
Increase in interest receivable	(123,519)
Decrease in receivable from broker variation margin on open futures contracts	750
Decrease in prepaid expenses	4,006
Decrease in principal paydown receivable	17,813
Increase in deposits with brokers for open futures contracts	(24,643)
Increase in deposits with brokers for open reverse repurchase agreements	(475,000)
Decrease in net premiums paid for OTC swap contracts	767,004
Decrease in payable for open OTC swap contracts	(644)
Increase in payable for securities purchased	1,829,525
Increase in investment management fee payable	14,205
Increase in Directors fees payable	5,754
Increase in interest payable	63,773
Increase in accrued expenses	169,659
Increase in payable to broker variation margin on open futures contracts	4,625
Net realized gain on investments	(21,090,500)
Change in unrealized appreciation of investments, OTC swap contracts and forward foreign currency transactions	(2,261,428)
<b>Net Cash Provided by Operating Activities*</b>	<b>22,701,436</b>
<b>Cash Flows from Financing Activities:</b>	
Distributions paid on common stock	(27,399,758)
Proceeds from reverse repurchase agreements	2,800,706
<b>Net Cash Used in Financing Activities</b>	<b>(24,599,052)</b>
<b>Net Decrease in Cash</b>	<b>(1,897,616)</b>
Cash at beginning of year	4,515,245
Cash at end of year	\$ 2,617,629

\* Included in operating expenses is cash of \$1,260,301 paid for interest on borrowings.

See Notes to Financial Statements.

## Financial highlights

For a share of capital stock outstanding throughout each year ended December 31, unless otherwise noted:

	2014 <sup>1</sup>	2013 <sup>1</sup>	2012	2011	2010 <sup>2</sup>
Net asset value, beginning of year	\$23.78	\$23.88	\$19.01	\$21.98	\$19.06 <sup>3</sup>
<b>Income (loss) from operations:</b>					
Net investment income	1.87	1.44	1.68	2.21	1.77
Net realized and unrealized gain (loss)	2.19	2.16	6.07	(3.26)	2.27
<i>Total income (loss) from operations</i>	<i>4.06</i>	<i>3.60</i>	<i>7.75</i>	<i>(1.05)</i>	<i>4.04</i>
<b>Less distributions from:</b>					
Net investment income	(1.75)	(1.62)	(1.80)	(1.92)	(1.12)
Net realized gains	(1.34)	(2.08)	(1.08)		
<i>Total distributions</i>	<i>(3.09)</i>	<i>(3.70)</i>	<i>(2.88)</i>	<i>(1.92)</i>	<i>(1.12)</i>
Net asset value, end of year	\$24.75	\$23.78	\$23.88	\$19.01	\$21.98
Market price, end of year	\$23.84	\$23.18	\$24.21	\$19.61	\$21.60
<i>Total return, based on NAV<sup>4,5</sup></i>	<i>17.55%</i>	<i>15.65%</i>	<i>42.32%</i>	<i>(5.07)%</i>	<i>21.81%</i>
<i>Total return, based on Market Price<sup>6</sup></i>	<i>16.76%</i>	<i>12.14%</i>	<i>40.09%</i>	<i>(0.35)%</i>	<i>14.08%</i>
Net assets, end of year (000s)	\$257,621	\$247,551	\$248,407	\$197,289	\$227,834
<b>Ratios to average net assets:</b>					
Gross expenses	2.36%	2.33%	1.89% <sup>7</sup>	2.24% <sup>7</sup>	2.04% <sup>7,8</sup>
Net expenses <sup>9</sup>	2.36	2.33	1.89 <sup>7</sup>	2.24 <sup>7</sup>	2.04 <sup>7,8</sup>
Net investment income	7.39	5.83	7.53	10.29	10.27 <sup>8</sup>
<b>Portfolio turnover rate</b>	<b>35%</b>	<b>32%</b>	<b>46%</b>	<b>13%</b>	<b>18%</b>
<b>Supplemental data:</b>					
Loans Outstanding, End of Year (000s)	\$116,700	\$116,700	\$30,000		
Asset Coverage for Loan Outstanding	321%	312%	927%		
Weighted Average Loan (000s)	\$116,700	\$112,256	\$32,720		
Weighted Average Interest Rate on Loans	1.02%	1.04%	1.08%		

<sup>1</sup> Per share amounts have been calculated using the average shares method.

<sup>2</sup> For the period February 24, 2010 (commencement of operations) to December 31, 2010.

<sup>3</sup> Initial public offering price of \$20.00 per share less offering costs and sales load totaling \$0.94 per share.

<sup>4</sup> Performance figures may reflect compensating balance arrangements, fee waivers and/or expense reimbursements. In the absence of compensating balance arrangements, fee waivers and/or expense reimbursements, the total return would have been lower. Past performance is no guarantee of future results. Total returns for periods of less than one year are not annualized.

<sup>5</sup> The total return calculation assumes that distributions are reinvested at NAV. Prior to January 1, 2012, the total return calculation assumed the reinvestment of all distributions in accordance with the Fund's dividend reinvestment plan. Past performance is no guarantee of future results. Total returns for periods of less than one year are not annualized.

<sup>6</sup> The total return calculation assumes that distributions are reinvested in accordance with the Fund's dividend reinvestment plan. Past performance is no guarantee of future results. Total returns for periods of less than one year are not annualized.

<sup>7</sup> Does not include expenses of PPIP Limited Partnership in which the Fund invested.

<sup>8</sup> Annualized.

<sup>9</sup> The impact of compensating balance arrangements, if any, was less than 0.01%.

[See Notes to Financial Statements.](#)

26 Western Asset Mortgage Defined Opportunity Fund Inc. 2014 Annual Report

## Notes to financial statements

### 1. Organization and significant accounting policies

Western Asset Mortgage Defined Opportunity Fund Inc. (the Fund) was incorporated in Maryland on December 11, 2009 and is registered as a non-diversified, limited-term, closed-end management investment company under the Investment Company Act of 1940, as amended (the 1940 Act). The Fund's primary investment objective is to provide current income. As a secondary investment objective, the Fund will seek capital appreciation. The Fund seeks to achieve its investment objectives by investing primarily in a diverse portfolio of mortgage-backed securities (MBS), consisting primarily of non-agency residential mortgage backed securities (RMBS) and commercial mortgage-backed securities (CMBS). The Fund intends to liquidate and distribute substantially all of the Fund's net assets to shareholders on or about March 1, 2022.

The following are significant accounting policies consistently followed by the Fund and are in conformity with U.S. generally accepted accounting principles (GAAP). Estimates and assumptions are required to be made regarding assets, liabilities and changes in net assets resulting from operations when financial statements are prepared. Changes in the economic environment, financial markets and any other parameters used in determining these estimates could cause actual results to differ. Subsequent events have been evaluated through the date the financial statements were issued.

**(a) Investment valuation.** The valuations for fixed income securities (which may include, but are not limited to, corporate, government, municipal, mortgage-backed, collateralized mortgage obligations and asset-backed securities) and certain derivative instruments are typically the prices supplied by independent third party pricing services, which may use market prices or broker/dealer quotations or a variety of valuation techniques and methodologies. The independent third party pricing services use inputs that are observable such as issuer details, interest rates, yield curves, prepayment speeds, credit risks/spreads, default rates and quoted prices for similar securities. Short-term fixed income securities that will mature in 60 days or less are valued at amortized cost, unless it is determined that using this method would not reflect an investment's fair value. Futures contracts are valued daily at the settlement price established by the board of trade or exchange on which they are traded. Equity securities for which market quotations are available are valued at the last reported sales price or official closing price on the primary market or exchange on which they trade. When the Fund holds securities or other assets that are denominated in a foreign currency, the Fund will normally use the currency exchange rates as of 4:00 p.m. (Eastern Time). If independent third party pricing services are unable to supply prices for a portfolio investment, or if the prices supplied are deemed by the manager to be unreliable, the market price may be determined by the manager using quotations from one or more broker/dealers or at the transaction price if the security has recently been purchased and no value has yet been obtained from a pricing service or pricing broker. When reliable prices are not readily available, such as when the value of a security has been significantly affected by events after the close of the exchange or market on which the security is principally traded, but before the Fund calculates its net asset value, the Fund values these securities as determined in accordance with procedures approved by the Fund's Board of Directors.

## Notes to financial statements (cont'd)

The Board of Directors is responsible for the valuation process and has delegated the supervision of the daily valuation process to the Legg Mason North American Fund Valuation Committee (the Valuation Committee). The Valuation Committee, pursuant to the policies adopted by the Board of Directors, is responsible for making fair value determinations, evaluating the effectiveness of the Fund's pricing policies, and reporting to the Board of Directors. When determining the reliability of third party pricing information for investments owned by the Fund, the Valuation Committee, among other things, conducts due diligence reviews of pricing vendors, monitors the daily change in prices and reviews transactions among market participants.

The Valuation Committee will consider pricing methodologies it deems relevant and appropriate when making fair value determinations. Examples of possible methodologies include, but are not limited to, multiple of earnings; discount from market of a similar freely traded security; discounted cash-flow analysis; book value or a multiple thereof; risk premium/yield analysis; yield to maturity; and/or fundamental investment analysis. The Valuation Committee will also consider factors it deems relevant and appropriate in light of the facts and circumstances. Examples of possible factors include, but are not limited to, the type of security; the issuer's financial statements; the purchase price of the security; the discount from market value of unrestricted securities of the same class at the time of purchase; analysts' research and observations from financial institutions; information regarding any transactions or offers with respect to the security; the existence of merger proposals or tender offers affecting the security; the price and extent of public trading in similar securities of the issuer or comparable companies; and the existence of a shelf registration for restricted securities.

For each portfolio security that has been fair valued pursuant to the policies adopted by the Board of Directors, the fair value price is compared against the last available and next available market quotations. The Valuation Committee reviews the results of such back testing monthly and fair valuation occurrences are reported to the Board of Directors quarterly.

The Fund uses valuation techniques to measure fair value that are consistent with the market approach and/or income approach, depending on the type of security and the particular circumstance. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable securities. The income approach uses valuation techniques to discount estimated future cash flows to present value.

GAAP establishes a disclosure hierarchy that categorizes the inputs to valuation techniques used to value assets and liabilities at measurement date. These inputs are summarized in the three broad levels listed below:

Level 1 quoted prices in active markets for identical investments

Level 2 other significant observable inputs (including quoted prices for similar investments, interest rates, prepayment speeds, credit risk, etc.)

Level 3 significant unobservable inputs (including the Fund's own assumptions in determining the fair value of investments)

The inputs or methodologies used to value securities are not necessarily an indication of the risk associated with investing in those securities.

## Edgar Filing: Western Asset Mortgage Defined Opportunity Fund Inc. - Form N-CSR

The following is a summary of the inputs used in valuing the Fund's assets and liabilities carried at fair value:

ASSETS				
Description	Quoted Prices (Level 1)	Other Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Long-term investments :				
Residential mortgage-backed securities		\$ 295,123,845	\$ 2,007,750	\$ 297,131,595
Asset-backed securities		30,113,123		30,113,123
Commercial mortgage-backed securities		47,450,576	5,499,482	52,950,058
Corporate bonds & notes		21,996,148		21,996,148
Total long-term investments		\$ 394,683,692	\$ 7,507,232	\$ 402,190,924
Short-term investments		743,000		743,000
<b>Total investments</b>		<b>\$ 395,426,692</b>	<b>\$ 7,507,232</b>	<b>\$ 402,933,924</b>
Other financial instruments:				
Forward foreign currency contracts		\$ 45,179		\$ 45,179
<b>Total</b>		<b>\$ 395,471,871</b>	<b>\$ 7,507,232</b>	<b>\$ 402,979,103</b>

  

LIABILITIES				
Description	Quoted Prices (Level 1)	Other Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Other financial instruments:				
Futures contracts	\$ 13,625			\$ 13,625

See Schedule of Investments for additional detailed categorizations.

The following is a reconciliation of investments in which significant unobservable inputs (Level 3) were used in determining fair value:

Investments in Securities	Residential Mortgage-Backed Securities	Commercial Mortgage-Backed Securities	Total
Balance as of December 31, 2013			
Accrued premiums/discounts	\$ 6,161	\$ 267	\$ 6,428
Realized gain (loss)			
Change in unrealized appreciation (depreciation) <sup>1</sup>	(4,661)	(267)	(4,928)
Purchases	2,006,250	5,499,482	7,505,732
Sales			
Transfers into Level 3			
Transfers out of Level 3			
<b>Balance as of December 31, 2014</b>	<b>\$ 2,007,750</b>	<b>\$ 5,499,482</b>	<b>\$ 7,507,232</b>
Net change in unrealized appreciation (depreciation) for investments in securities still held at December 31, 2014 <sup>1</sup>	\$ (4,661)	\$ (267)	\$ (4,928)

The Funds policy is to recognize transfers between levels as of the end of the reporting period.

<sup>1</sup> This amount is included in the change in net unrealized appreciation (depreciation) in the accompanying Statement of Operations. Change in unrealized appreciation (depreciation) includes net unrealized appreciation (depreciation) resulting from changes in investment values during the reporting period and the reversal of previously recorded unrealized appreciation (depreciation) when gains or losses are realized.

## Notes to financial statements (cont d)

**(b) Repurchase agreements.** The Fund may enter into repurchase agreements with institutions that its investment adviser has determined are creditworthy. Each repurchase agreement is recorded at cost. Under the terms of a typical repurchase agreement, the Fund acquires a debt security subject to an obligation of the seller to repurchase, and of the Fund to resell, the security at an agreed-upon price and time, thereby determining the yield during the Fund's holding period. When entering into repurchase agreements, it is the Fund's policy that its custodian or a third party custodian, acting on the Fund's behalf, take possession of the underlying collateral securities, the market value of which, at all times, at least equals the principal amount of the repurchase transaction, including accrued interest. To the extent that any repurchase transaction maturity exceeds one business day, the value of the collateral is marked-to-market and measured against the value of the agreement in an effort to ensure the adequacy of the collateral. If the counterparty defaults, the Fund generally has the right to use the collateral to satisfy the terms of the repurchase transaction. However, if the market value of the collateral declines during the period in which the Fund seeks to assert its rights or if bankruptcy proceedings are commenced with respect to the seller of the security, realization of the collateral by the Fund may be delayed or limited.

**(c) Reverse repurchase agreements.** The Fund may enter into reverse repurchase agreements. Under the terms of a typical reverse repurchase agreement, a fund sells a security subject to an obligation to repurchase the security from the buyer at an agreed-upon time and price. In the event the buyer of securities under a reverse repurchase agreement files for bankruptcy or becomes insolvent, the Fund's use of the proceeds of the agreement may be restricted pending a determination by the counterparty, or its trustee or receiver, whether to enforce the Fund's obligation to repurchase the securities. In entering into reverse repurchase agreements, the Fund will maintain cash, U.S. government securities or other liquid debt obligations at least equal in value to its obligations with respect to reverse repurchase agreements or will take other actions permitted by law to cover its obligations. Interest payments made on reverse repurchase agreements are recognized as a component of Interest expense on the Statement of Operations. In periods of increased demand for the security, a Fund may receive a fee for use of the security by the counterparty, which may result in interest income to the Fund.

**(d) Futures contracts.** The Fund uses futures contracts generally to gain exposure to, or hedge against, changes in interest rates or gain exposure to, or hedge against, changes in certain asset classes. A futures contract represents a commitment for the future purchase or sale of an asset at a specified price on a specified date.

Upon entering into a futures contract, the Fund is required to deposit cash or cash equivalents with a broker in an amount equal to a certain percentage of the contract amount. This is known as the initial margin and subsequent payments (variation margin) are made or received by the Fund each day, depending on the daily fluctuation in the value of the contract. For certain futures, including foreign denominated futures, variation margin is not settled daily, but is recorded as a net variation margin payable or receivable. Futures contracts are valued daily at the settlement price established by the board of trade or

exchange on which they are traded. The daily changes in contract value are recorded as unrealized gains or losses in the Statement of Operations and the Fund recognizes a realized gain or loss when the contract is closed.

Futures contracts involve, to varying degrees, risk of loss in excess of the amounts reflected in the financial statements. In addition, there is the risk that the Fund may not be able to enter into a closing transaction because of an illiquid secondary market.

**(e) Forward foreign currency contracts.** The Fund enters into a forward foreign currency contract to hedge against foreign currency exchange rate risk on its non-U.S. dollar denominated securities or to facilitate settlement of a foreign currency denominated portfolio transaction. A forward foreign currency contract is an agreement between two parties to buy and sell a currency at a set price with delivery and settlement at a future date. The contract is marked-to-market daily and the change in value is recorded by the Fund as an unrealized gain or loss. When a forward foreign currency contract is closed, through either delivery or offset by entering into another forward foreign currency contract, the Fund recognizes a realized gain or loss equal to the difference between the value of the contract at the time it was opened and the value of the contract at the time it is closed.

Forward foreign currency contracts involve elements of market risk in excess of the amounts reflected on the Statement of Assets and Liabilities. The Fund bears the risk of an unfavorable change in the foreign exchange rate underlying the forward foreign currency contract. Risks may also arise upon entering into these contracts from the potential inability of the counterparties to meet the terms of their contracts.

**(f) Foreign currency translation.** Investment securities and other assets and liabilities denominated in foreign currencies are translated into U.S. dollar amounts based upon prevailing exchange rates on the date of valuation. Purchases and sales of investment securities and income and expense items denominated in foreign currencies are translated into U.S. dollar amounts based upon prevailing exchange rates on the respective dates of such transactions.

The Fund does not isolate that portion of the results of operations resulting from fluctuations in foreign exchange rates on investments from the fluctuations arising from changes in market prices of securities held. Such fluctuations are included with the net realized and unrealized gain or loss on investments.

Net realized foreign exchange gains or losses arise from sales of foreign currencies, including gains and losses on forward foreign currency contracts, currency gains or losses realized between the trade and settlement dates on securities transactions, and the difference between the amounts of dividends, interest, and foreign withholding taxes recorded on the Fund's books and the U.S. dollar equivalent of the amounts actually received or paid. Net unrealized foreign exchange gains and losses arise from changes in the values of assets and liabilities, other than investments in securities, on the date of valuation, resulting from changes in exchange rates.



## Notes to financial statements (cont d)

Foreign security and currency transactions may involve certain considerations and risks not typically associated with those of U.S. dollar denominated transactions as a result of, among other factors, the possibility of lower levels of governmental supervision and regulation of foreign securities markets and the possibility of political or economic instability.

**(g) Leverage.** The Fund may seek to enhance the level of its current distributions to holders of common stock through the use of leverage. The Fund may use leverage directly at the Fund level through borrowings, including loans from certain financial institutions or through a qualified government sponsored program, the use of reverse repurchase agreements and/or the issuance of debt securities (collectively, Borrowings), and possibly through the issuance of preferred stock ( Preferred Stock ), in an aggregate amount of up to approximately 33% of the Fund's Total Assets immediately after such Borrowings and/or issuances of Preferred Stock. Total Assets means net assets of the Fund plus the amount of any Borrowings and assets attributable to Preferred Stock that may be outstanding. Currently, the Fund has no intention to issue notes or debt securities or Preferred Stock. In addition, the Fund may enter into additional reverse repurchase agreements and/or use similar investment management techniques that may provide leverage, but which are not subject to the foregoing 33 1/3% limitation so long as the Fund has covered its commitment with respect to such techniques by segregating liquid assets, entering into offsetting transactions or owning positions covering related obligations.

**(h) Mortgage-backed securities.** Mortgage-Backed Securities ( MBS ) include CMBS and RMBS. These securities depend on payments (except for rights or other assets designed to assure the servicing or timely distribution of proceeds to holders of such securities) primarily from the cash flow from secured commercial or residential mortgage loans made to borrowers. Such loans are secured (on a first priority basis or second priority basis, subject to permitted liens, easements and other encumbrances) by commercial or residential real estate, the proceeds of which are used to purchase and/or to construct commercial or residential real estate. The value of some mortgage-backed securities may be particularly sensitive to changes in prevailing interest rates. The value of these securities may fluctuate in response to the market's perception of the creditworthiness of the issuers. Additionally, although certain mortgage-related securities are supported by some form of government or private guarantee and/or insurance, there is no assurance that private guarantors or insurers will meet their obligations.

**(i) Stripped securities.** The Fund may invest in Stripped Securities, a term used collectively for components, or strips, of fixed income securities. Stripped securities can be principal only securities ( PO ), which are debt obligations that have been stripped of unmatured interest coupons, or interest only securities ( IO ), which are unmatured interest coupons that have been stripped from debt obligations. The market value of Stripped Securities will fluctuate in response to changes in economic conditions, rates of pre-payment, interest rates and the market's perception of the securities. However, fluctuations in response to interest rates may be greater in Stripped Securities than for debt obligations of comparable maturities that pay interest currently. The amount of fluctuation may increase with a longer period of maturity.

The yield to maturity on IOs is sensitive to the rate of principal repayments (including prepayments) on the related underlying debt obligation and principal payments may have a material effect on yield to maturity. If the underlying debt obligation experiences greater than anticipated prepayments of principal, the Fund may not fully recoup its initial investment in IOs.

**(j) Loan participations.** The Fund may invest in loans arranged through private negotiation between one or more financial institutions. The Fund's investment in any such loan may be in the form of a participation in or an assignment of the loan. In connection with purchasing participations, the Fund generally will have no right to enforce compliance by the borrower with the terms of the loan agreement related to the loan, or any rights of off-set against the borrower and the Fund may not benefit directly from any collateral supporting the loan in which it has purchased the participation.

The Fund assumes the credit risk of the borrower, the lender that is selling the participation and any other persons interpositioned between the Fund and the borrower. In the event of the insolvency of the lender selling the participation, the Fund may be treated as a general creditor of the lender and may not benefit from any off-set between the lender and the borrower.

**(k) Swap agreements.** The Fund invests in swaps for the purpose of managing its exposure to interest rate, credit or market risk, or for other purposes, including to increase the Fund's return. The use of swaps involves risks that are different from those associated with other portfolio transactions. Swap agreements are privately negotiated in the over-the-counter market (OTC Swaps) or may be executed on a registered exchange (Centrally Cleared Swaps). Unlike Centrally Cleared Swaps, the Fund has credit exposure to the counterparties of OTC Swaps.

Swap contracts are marked-to-market daily and changes in value are recorded as unrealized appreciation (depreciation). The daily change in valuation of Centrally Cleared Swaps, if any, is recorded as a receivable or payable for variation margin on the Statement of Assets and Liabilities. Gains or losses are realized upon termination of the swap agreement. Collateral, in the form of restricted cash or securities, may be required to be held in segregated accounts with the Fund's custodian in compliance with the terms of the swap contracts. Securities posted as collateral for swap contracts are identified in the Schedule of Investments and restricted cash, if any, is identified on the Statement of Assets and Liabilities. Risks may exceed amounts recorded in the Statement of Assets and Liabilities. These risks include changes in the returns of the underlying instruments, failure of the counterparties to perform under the contracts' terms, and the possible lack of liquidity with respect to the swap agreements.

OTC swap payments received or made at the beginning of the measurement period are reflected as a premium or deposit, respectively, on the Statement of Assets and Liabilities. These upfront payments are amortized over the life of the swap and are recognized as realized gain or loss in the Statement of Operations. Net periodic payments received or paid by the Fund are recognized as a realized gain or loss in the Statement of Operations.

## Notes to financial statements (cont'd)

The Fund's maximum exposure in the event of a defined credit event on a credit default swap to sell protection is the notional amount. As of December 31, 2014, the Fund did not hold any credit default swaps to sell protection.

For average notional amounts of swaps held during the year ended December 31, 2014, see Note 4.

### Credit default swaps

The Fund enters into credit default swap (CDS) contracts for investment purposes, to manage its credit risk or to add leverage. CDS agreements involve one party making a stream of payments to another party in exchange for the right to receive a specified return in the event of a default by a third party, typically corporate or sovereign issuers, on a specified obligation, or in the event of a write-down, principal shortfall, interest shortfall or default of all or part of the referenced entities comprising a credit index. The Fund may use a CDS to provide protection against defaults of the issuers (i.e., to reduce risk where the Fund has exposure to an issuer) or to take an active long or short position with respect to the likelihood of a particular issuer's default. As a seller of protection, the Fund generally receives an upfront payment or a stream of payments throughout the term of the swap provided that there is no credit event. If the Fund is a seller of protection and a credit event occurs, as defined under the terms of that particular swap agreement, the maximum potential amount of future payments (undiscounted) that the Fund could be required to make under a credit default swap agreement would be an amount equal to the notional amount of the agreement. These amounts of potential payments will be partially offset by any recovery of values from the respective referenced obligations. As a seller of protection, the Fund effectively adds leverage to its portfolio because, in addition to its total net assets, the Fund is subject to investment exposure on the notional amount of the swap. As a buyer of protection, the Fund generally receives an amount up to the notional value of the swap if a credit event occurs.

Implied spreads are the theoretical prices a lender receives for credit default protection. When spreads rise, market perceived credit risk rises and when spreads fall, market perceived credit risk falls. The implied credit spread of a particular referenced entity reflects the cost of buying/selling protection and may include upfront payments required to enter into the agreement. Wider credit spreads and decreasing market values, when compared to the notional amount of the swap, represent a deterioration of the referenced entity's credit soundness and a greater likelihood or risk of default or other credit event occurring as defined under the terms of the agreement. Credit spreads utilized in determining the period end market value of credit default swap agreements on corporate or sovereign issues are disclosed in the Notes to Financial Statements and serve as an indicator of the current status of the payment/performance risk and represent the likelihood or risk of default for credit derivatives. For credit default swap agreements on asset-backed securities and credit indices, the quoted market prices and resulting values, particularly in relation to the notional amount of the contract as well as the annual payment rate, serve as an indication of the current status of the payment/performance risk.

The Fund's maximum risk of loss from counterparty risk, as the protection buyer, is the fair value of the contract (this risk is mitigated by the posting of collateral by the counterparty to the Fund to cover the Fund's exposure to the counterparty). As the protection seller, the Fund's maximum risk is the notional amount of the contract. Credit default swaps are considered to have credit risk-related contingent features since they require payment by the protection seller to the protection buyer upon the occurrence of a defined credit event.

Entering into a CDS agreement involves, to varying degrees, elements of credit, market and documentation risk in excess of the related amounts recognized on the Statement of Assets and Liabilities. Such risks involve the possibility that there will be no liquid market for these agreements, that the counterparty to the agreement may default on its obligation to perform or disagree as to the meaning of the contractual terms in the agreement, and that there will be unfavorable changes in net interest rates.

**(l) Cash flow information.** The Fund invests in securities and distributes dividends from net investment income and net realized gains, which are paid in cash and may be reinvested at the discretion of shareholders. These activities are reported in the Statement of Changes in Net Assets and additional information on cash receipts and cash payments are presented in the Statement of Cash Flows.

**(m) Credit and market risk.** Investments in securities that are collateralized by residential real estate mortgages are subject to certain credit and liquidity risks. When market conditions result in an increase in default rates of the underlying mortgages and the foreclosure values of underlying real estate properties are materially below the outstanding amount of these underlying mortgages, collection of the full amount of accrued interest and principal on these investments may be doubtful. Such market conditions may significantly impair the value and liquidity of these investments and may result in a lack of correlation between their credit ratings and values.

**(n) Foreign investment risks.** The Fund's investments in foreign securities may involve risks not present in domestic investments. Since securities may be denominated in foreign currencies, may require settlement in foreign currencies or pay interest or dividends in foreign currencies, changes in the relationship of these foreign currencies to the U.S. dollar can significantly affect the value of the investments and earnings of the Fund. Foreign investments may also subject the Fund to foreign government exchange restrictions, expropriation, taxation or other political, social or economic developments, all of which affect the market and/or credit risk of the investments.

**(o) Counterparty risk and credit-risk-related contingent features of derivative instruments.** The Fund may invest in certain securities or engage in other transactions, where the Fund is exposed to counterparty credit risk in addition to broader market risks. The Fund may invest in securities of issuers, which may also be considered counterparties as trading partners in other transactions. This may increase the risk of loss in the event of default or bankruptcy by the counterparty or if the counterparty otherwise fails to meet its contractual obligations. The Fund's investment manager attempts to mitigate counterparty

## Notes to financial statements (cont d)

risk by (i) periodically assessing the creditworthiness of its trading partners, (ii) monitoring and/or limiting the amount of its net exposure to each individual counterparty based on its assessment and (iii) requiring collateral from the counterparty for certain transactions. Market events and changes in overall economic conditions may impact the assessment of such counterparty risk by the investment manager. In addition, declines in the values of underlying collateral received may expose the Fund to increased risk of loss.

The Fund has entered into master agreements with certain of its derivative counterparties that provide for general obligations, representations, agreements, collateral, events of default or termination and credit related contingent features. The credit related contingent features include, but are not limited to, a percentage decrease in the Fund's net assets or NAV over a specified period of time. If these credit related contingent features were triggered, the derivatives counterparty could terminate the positions and demand payment or require additional collateral.

Collateral requirements differ by type of derivative. Collateral or margin requirements are set by the broker or exchange clearinghouse for exchange traded derivatives while collateral terms are contract specific for over-the-counter traded derivatives. Cash collateral that has been pledged to cover obligations of the Fund under derivative contracts, if any, will be reported separately in the Statement of Assets and Liabilities. Securities pledged as collateral, if any, for the same purpose are noted in the Schedule of Investments.

Absent an event of default by the counterparty or a termination of the agreement, the terms of the master agreements do not result in an offset of reported amounts of financial assets and financial liabilities in the Statement of Assets and Liabilities across transactions between the Fund and the applicable counterparty. The enforceability of the right to offset may vary by jurisdiction.

As of December 31, 2014, the Fund did not have any open derivative transactions with credit related contingent features in a net liability position.

**(p) Security transactions and investment income.** Security transactions are accounted for on a trade date basis. Interest income, adjusted for amortization of premium and accretion of discount, is recorded on the accrual basis. The Fund accretes market discounts and amortizes market premiums on debt securities using the effective yield method. Accretion of market discounts and amortization of market premiums requires the application of several assumptions including, but not limited to, prepayment assumptions and default rate assumptions, which are re-evaluated not less than semi-annually and require the use of a significant amount of judgment. Principal write-offs are generally treated as realized losses. The Fund's accretion of discounts and amortization of premiums for U.S. federal and other tax purposes is likely to differ from the financial accounting treatment under GAAP of these items as described above. Dividend income is recorded on the ex-dividend date. The cost of investments sold is determined by use of the specific identification method. To the extent any issuer defaults or a credit event occurs that impacts the issuer, the Fund may halt any additional interest income accruals and consider the realizability of interest accrued up to the date of default or credit event.

**(q) Distributions to shareholders.** Distributions from net investment income of the Fund, if any, are declared quarterly and paid on a monthly basis. Distributions of net realized gains, if any, are declared at least annually. Distributions to shareholders of the Fund are recorded on the ex-dividend date and are determined in accordance with income tax regulations, which may differ from GAAP.

**(r) Compensating balance arrangements.** The Fund has an arrangement with its custodian bank whereby a portion of the custodian's fees is paid indirectly by credits earned on the Fund's cash on deposit with the bank.

**(s) Federal and other taxes.** It is the Fund's policy to comply with the federal income and excise tax requirements of the Internal Revenue Code of 1986 (the Code), as amended, applicable to regulated investment companies. Accordingly, the Fund intends to distribute its taxable income and net realized gains, if any, to shareholders in accordance with timing requirements imposed by the Code. Therefore, no federal or state income tax provision is required in the Fund's financial statements. However, due to the timing of when distributions are made, the Fund may be subject to an excise tax of 4% of the amount by which 98% of the Fund's annual taxable income and 98.2% of net realized gains exceed the distributions from such taxable income and realized gains for the calendar year. The Fund paid \$341,344 of federal excise taxes attributable to calendar year 2013 in March 2014. The Fund anticipates being subject to an excise tax for calendar year 2014 of approximately \$512,000.

Management has analyzed the Fund's tax positions taken on income tax returns for all open tax years and has concluded that as of December 31, 2014 no provision for income tax is required in the Fund's financial statements. The Fund's federal and state income and federal excise tax returns for tax years for which the applicable statutes of limitations have not expired are subject to examination by the Internal Revenue Service and state departments of revenue.

Under the applicable foreign tax laws, a withholding tax may be imposed on interest, dividends and capital gains at various rates.

**(t) Reclassification.** GAAP requires that certain components of net assets be reclassified to reflect permanent differences between financial and tax reporting. These reclassifications have no effect on net assets or net asset value per share. During the current year, the following reclassifications have been made:

	Undistributed Net Investment Income	Accumulated Net Realized Gain	Paid-in Capital
(a)	\$ 511,448		\$ (511,448)
(b)	(27,658)	\$ 27,658	

(a) Reclassifications are primarily due to a non-deductible excise tax accrued by the Fund.

(b) Reclassifications are due to foreign currency transactions treated as ordinary income for tax purposes and book/tax differences in the treatment of swap contracts.

## Notes to financial statements (cont d)

### 2. Investment management agreement and other transactions with affiliates

Legg Mason Partners Fund Advisor, LLC ( LMPFA ) is the Fund's investment manager. Western Asset Management Company ( Western Asset ) and Western Asset Limited ( Western Asset Limited ) are the Fund's subadvisers. LMPFA, Western Asset and Western Asset Limited are wholly-owned subsidiaries of Legg Mason, Inc. ( Legg Mason ).

Under the investment management agreement, the Fund pays an investment management fee, calculated daily and paid monthly, at an annual rate of 1.00% of the Fund's average daily managed assets. Managed Assets are net assets plus the proceeds of any outstanding borrowings used for leverage.

During periods in which the Fund utilizes financial leverage, the fees which are payable to the investment manager as a percentage of the Fund's assets will be higher than if the Fund did not utilize leverage because the fees are calculated as a percentage of the Fund's assets, including those investments purchased with leverage.

LMPFA provides administrative and certain oversight services to the Fund. LMPFA delegates to Western Asset the day-to-day portfolio management of the Fund. Western Asset Limited provides certain subadvisory services to the Fund relating to currency transactions and investments in non-U.S. dollar denominated debt securities. For its services, LMPFA pays Western Asset 70% of the net management fee it receives from the Fund. In turn, Western Asset pays Western Asset Limited a subadvisory fee of 0.70% of the Fund's daily Managed Assets that the subadviser allocates to Western Asset Limited to manage.

All officers and one Director of the Fund are employees of Legg Mason or its affiliates and do not receive compensation from the Fund.

### 3. Investments

During the year ended December 31, 2014, the aggregate cost of purchases and proceeds from sales of investments (excluding short-term investments) and U.S Government & Agency Obligations were as follows:

	Investments	U.S. Government & Agency Obligations
Purchases	\$ 138,229,458	
Sales	142,569,624	\$ 1,010,589

At December 31, 2014, the aggregate gross unrealized appreciation and depreciation of investments for federal income tax purposes were as follows:

Gross unrealized appreciation	\$ 53,750,929
Gross unrealized depreciation	(4,999,076)
<b>Net unrealized appreciation</b>	<b>\$ 48,751,853</b>

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Transactions in reverse repurchase agreements for the Fund during the year ended December 31, 2014 were as follows:

Average Daily Balance*	Weighted Average Interest Rate*	Maximum Amount Outstanding
\$15,857,269	0.85%	\$ 17,769,651

\* Averages based on the number of days that Fund had reverse repurchase agreements outstanding. Interest rates on reverse repurchase agreements ranged from 0.65% to 1.75% during the year ended December 31, 2014. Interest expense incurred on reverse repurchase agreements totaled \$134,824.

At December 31, 2014, the Fund had the following open reverse repurchase agreements:

Counterparty	Rate	Effective Date	Maturity Date	Face Amount of Reverse Repurchase Agreements
Barclays Capital Inc.	0.98%	10/21/14	1/21/15	\$ 1,598,108
Barclays Capital Inc.	1.00%	12/19/14	1/21/15	2,430,000
Credit Suisse	0.65%	6/26/13	TBD*	2,095,380
Credit Suisse	0.75%	6/26/13	TBD*	1,990,450
Credit Suisse	0.65%	10/25/13	TBD*	1,771,875
Credit Suisse	0.65%	6/23/14	TBD*	2,050,650
Credit Suisse	0.85%	6/23/14	TBD*	2,217,600
Deutsche Bank AG	0.75%	3/10/14	TBD*	3,523,360
				<b>\$ 17,677,423</b>

\* TBD To Be Determined; These reverse repurchase agreements have no maturity dates because they are renewed daily and can be terminated by either the Fund or the counterparty in accordance with the terms of the agreements.

On December 31, 2014, the total market value of underlying collateral (refer to the Schedule of Investments for positions held at the counterparty as collateral for reverse repurchase agreements) for open reverse repurchase agreements was \$21,222,687. In addition, on December 31, 2014, cash collateral in the amount of \$475,000 was pledged for open reverse repurchase agreements.

At December 31, 2014, the Fund had the following open futures contracts:

	Number of Contracts	Expiration Date	Basis Value	Market Value	Unrealized Depreciation
<b>Contracts to Sell:</b>					
U.S. Treasury 5-Year Notes	10	3/15	\$ 1,187,967	\$ 1,189,297	\$ (1,330)
U.S. Treasury 10-Year Notes	14	3/15	1,762,861	1,775,156	(12,295)
<b>Net unrealized depreciation on open futures contracts</b>					<b>\$ (13,625)</b>

At December 31, 2014, the Fund had the following open forward foreign currency contracts:

Currency Purchased	Currency Sold	Counterparty	Settlement Date	Unrealized Appreciation
USD 1,376,759	EUR 1,100,000	Citibank, N.A.	2/13/15	\$ 45,179

**Abbreviations used in this table:**

EUR Euro  
USD United States Dollar





## Notes to financial statements (cont'd)

### 4. Derivative instruments and hedging activities

Below is a table, grouped by derivative type, that provides information about the fair value and the location of derivatives within the Statement of Assets and Liabilities at December 31, 2014.

<b>ASSET DERIVATIVES<sup>1</sup></b>	
Forward foreign currency contracts	Foreign Exchange Risk \$ 45,179
<b>LIABILITY DERIVATIVES<sup>1</sup></b>	
Futures contracts <sup>2</sup>	Interest Rate Risk \$ 13,625

<sup>1</sup> Generally, the balance sheet location for asset derivatives is receivables/net unrealized appreciation (depreciation) and for liability derivatives is payables/net unrealized appreciation (depreciation).

<sup>2</sup> Includes cumulative appreciation (depreciation) of futures contracts as reported in the footnotes. Only variation margin is reported within the receivables and/or payables on the Statement of Assets and Liabilities.

The following tables provide information about the effect of derivatives and hedging activities on the Fund's Statement of Operations for the year ended December 31, 2014. The first table provides additional detail about the amounts and sources of gains (losses) realized on derivatives during the period. The second table provides additional information about the change in unrealized appreciation (depreciation) resulting from the Fund's derivatives and hedging activities during the period.

#### AMOUNT OF REALIZED GAIN (LOSS) ON DERIVATIVES RECOGNIZED

	Interest Rate Risk	Foreign Exchange Risk	Credit Risk	Total
Futures contracts	\$ (12,856)			\$ (12,856)
Swap contracts			\$ (604,544)	(604,544)
Forward foreign currency contracts <sup>1</sup>		\$ 17,084		17,084
<b>Total</b>	<b>\$ (12,856)</b>	<b>\$ 17,084</b>	<b>\$ (604,544)</b>	<b>\$ (600,316)</b>

<sup>1</sup> Net realized gain (loss) from forward foreign currency contracts is reported in net realized gain (loss) from foreign currency transactions in the Statement of Operations.

#### CHANGE IN UNREALIZED APPRECIATION (DEPRECIATION) ON DERIVATIVES RECOGNIZED

	Interest Rate Risk	Foreign Exchange Risk	Foreign Exchange	Total
Futures contracts	\$ (27,661)			\$ (27,661)
Swap contracts			\$ 452,099	452,099
Forward foreign currency contracts <sup>1</sup>		\$ 45,179		45,179
<b>Total</b>	<b>\$ (27,661)</b>	<b>\$ 45,179</b>	<b>\$ 452,099</b>	<b>\$ 469,617</b>

<sup>1</sup> The change in unrealized appreciation (depreciation) from forward foreign currency contracts is reported in the change in net unrealized appreciation (depreciation) from foreign currencies in the Statement of Operations.



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During the year ended December 31, 2014, the volume of derivative activity for the Fund was as follows:

	Average Market Value
Futures contracts (to sell)	\$ 1,237,807
Forward foreign currency contracts (to sell)	313,741
	Average Notional Balance
Credit default swap contracts (to buy protection) <sup>1</sup>	\$ 29,252,192

<sup>1</sup> At December 31, 2014, there were no open positions held in this derivative.

The following table presents by financial instrument, the Fund's derivative assets net of the related collateral received by the Fund at December 31, 2014:

	Gross Amount of Derivative Assets in the Statement of Assets and Liabilities <sup>1</sup>	Collateral Received	Net Amount
Forward foreign currency contracts	\$ 45,179		\$ 45,179

The following table presents by financial instrument, the Fund's derivative liabilities net of the related collateral pledged by the Fund at December 31, 2014:

	Gross Amount of Derivative Liabilities in the Statement of Assets and Liabilities <sup>1</sup>	Collateral Pledged <sup>2,3</sup>	Net Amount
Futures contracts <sup>4</sup>	\$ 4,625	\$ (4,625)	

<sup>1</sup> Absent an event of default or early termination, derivative assets and liabilities are presented gross and not offset in the Statement of Assets and Liabilities.

<sup>2</sup> Gross amounts are not offset in the Statement of Assets and Liabilities.

<sup>3</sup> In some instances, the actual collateral received and/or pledged may be more than the amount shown here due to overcollateralization.

<sup>4</sup> Amount represents the current day's variation margin as reported in the Statement of Assets and Liabilities. It differs from the cumulative appreciation (depreciation) presented in the previous table.

## 5. Distributions subsequent to December 31, 2014

The following distributions have been declared by the Fund's Board of Directors and are payable subsequent to the period end of this report:

Record Date	Payable Date	Amount
12/31/2014	1/26/2015	\$ 1.2161*
1/23/2015	1/30/2015	\$ 0.1600
2/20/2015	2/27/2015	\$ 0.1600
3/20/2015	3/27/2015	\$ 0.1800

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4/17/2015	4/24/2015	\$ 0.1800
5/22/2015	5/29/2015	\$ 0.1800

\* Distribution comprised of \$0.0528 from short-term capital gains and \$1.1633 from long-term capital gains.

## Notes to financial statements (cont d)

### 6. Loan

The Fund has a revolving credit agreement with State Street Bank and Trust Company that allows the Fund to borrow up to an aggregate amount of \$127,000,000 and renews daily for a 270-day term unless notice to the contrary is given to the Fund. The Fund pays a commitment fee at an annual rate of 0.10% on the unutilized portion of the loan commitment amount. The interest on the loan is calculated at a variable rate based on the one-month LIBOR, plus any applicable margin. To the extent of the borrowing outstanding, the Fund is required to maintain collateral in a special custody account at the Fund's custodian on behalf of State Street Bank and Trust Company. The Fund's credit agreement contains customary covenants that, among other things, may limit the Fund's ability to pay distributions in certain circumstances, incur additional debt, change its fundamental investment policies and engage in certain transactions, including mergers and consolidations, and require asset coverage ratios in addition to those required by the 1940 Act. In addition, the credit agreement may be subject to early termination under certain conditions and may contain other provisions that could limit the Fund's ability to utilize borrowing under the agreement. Interest expense related to the loan for the year ended December 31, 2014 was \$1,189,250. For the year ended December 31, 2014, the Fund incurred commitment fees in the amount of \$10,443. At December 31, 2014, the Fund had \$116,700,000 of borrowings outstanding per this credit agreement. For the year ended December 31, 2014, based on the number of days during the reporting period that the Fund had a loan balance outstanding, the average daily loan balance was \$116,700,000 and the weighted average interest rate was 1.02%.

### 7. Income tax information and distributions to shareholders

The tax character of distributions paid during the fiscal years ended December 31 was as follows:

	2014	2013
<b>Distributions paid from:</b>		
Ordinary income	\$ 19,663,613	\$ 21,842,910
Net long-term capital gains	12,464,656	16,664,308
<b>Total distributions paid</b>	<b>\$ 32,128,269</b>	<b>\$ 38,507,218</b>

As of December 31, 2014, the components of accumulated earnings on a tax basis were as follows:

Undistributed ordinary income - net	\$ 11,953,048
Undistributed long-term capital gains - net	3,332
Undistributed ordinary income - net	\$ 11,956,380
Other book/tax temporary differences <sup>(a)</sup>	(266,419)