LEGG MASON
GLOBAL ASSET MANAGEMENT

Legg Mason
Australian Core Equity Trust

Objective

The Trust aims to earn a before fees and taxes return of 3% p.a. in excess of its benchmark over rolling three year periods.

Benchmark

S&P/ASX 200 Accumulation Index.

Value

$85,365,196.

Performance (before fees and taxes)

	Trust %	Benchmark %
3 months	4.96	4.38
1 year	1.62	1.57
3 years p.a.	-4.69	-5.02
5 years p.a.	4.10	4.32

Past performance is no indication of future performance.

Profile

Overweight Positions	Active %
Tower Australia	+2.8
Iluka Resources	+2.6
ANZ Banking Group	+2.5
News Corporation	+2.5
ASX	+2.4
Rio Tinto	+2.3
Amcor	+2.3
Seek	+2.2
Henderson Group	+2.1
National Australia Bank	+2.0

Underweight Positions	Active %
Woodside Petroleum	-2.3
Telstra Corporation	-2.1
Newcrest Mining	-2.0
CSL	-1.8
QBE Insurance	-1.7

Market Review

Equity markets gained ground over the December quarter as investors were generally positive on the economic outlook heading into 2011. This reflected positive momentum in macro data, particularly further quantitative easing in the U.S.

Concerns around European sovereign debt contagion and increased interest rates in China tempered the gains of a number of equity markets.

The Australian equity sector gained 4.4% over the quarter, as measured by the S&P/ASX 200 Accumulation Index. The gain over the year to 31 December 2010 was 1.6%.

Materials companies as well as a selection of small capitalised stocks outperformed during the quarter, in line with higher commodity prices and increased investor tolerance for risk. On the other side of the ledger, investors reduced their exposure to the more defensive Property, Consumer Staples and Telecommunication Services sectors.

Merger and acquisition activity was a feature of the Australian equity market during the quarter. The Singapore Exchange made a bid for the ASX (+15.7%) and Japanese insurer Dai-ichi Life announced it had entered into a scheme implementation deed to acquire the 71% of Tower Australia (+65.4%) that it did not already own. Meanwhile, James Packer acquired a substantial shareholding in the Ten Network (+2.2%).

Australian economic releases this quarter saw credit growth, retail sales and house prices all trend lower. However, employment growth remained robust. In October the Reserve Bank of Australia increased the target cash rate by 0.25% to 4.75%, which was quickly followed by a further 0.15% to 0.20% increase to mortgage rates by the major banks.

Meanwhile, the Australian dollar appreciated US4.96 cents against the U.S. dollar to finish the quarter at US$1.02. The Australian dollar gained US11.94 cents over the past year.

Performance

The Legg Mason Australian Core Equity Trust outperformed its benchmark by 0.6% over the quarter.

Performance was aided by the portfolio's holdings in the Financials ex Banks & Property and Metals & Mining sectors.

In the Financials ex Banks & Property sector, the portfolio's overweight exposure to Tower Australia (+65.4%) and ASX (+15.7%) added value as both were the focus of corporate activity.

Tower surged late in the period as the life insurer was the focus of the aforementioned corporate activity by Dai-ichi Life. We have been overweight Tower for some time as we forecast that the company would be able to produce double digit top line growth and increased returns on equity over the medium term. The announcement by Dai-ichi is near term recognition of the significant medium term value we ascribed to Tower Australia. We will assess the value of Dai-ichi Life's proposal.

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ASX gained ground on a bid for the company by the Singapore Exchange. The ASX's current trading price is lower than the value offered by the Singapore Exchange due to uncertainty regarding regulatory hurdles and the need for parliamentary support. The ASX had been trading below our measure of the firm's intrinsic value due to excessive concerns about the impact of competition. Our view is that the global exchange landscape will move from national monopolies to competing global exchanges and that the Singapore Exchange bid for ASX is an early step in that direction.

Exposure to Metals & Mining added value as the portfolio was overweight mineral sands firm Iluka Resources (+52.3%) as well as diversified resource heavyweights BHP Billiton (+16.3%) and Rio Tinto (+11.3%). Also in Materials, exposure to Mount Gibson Iron (+21.2%) added value.

Iluka Resources gained ground as it released a quarterly report that cited increased production, strong sales volumes, improved revenues and price increases. We anticipated Iluka's dominant positions in zircon and titanium inputs and have been long term holders of the company; the stock more than doubled during 2010. BHP and Rio were stronger on the back of higher commodity prices. Further, the prospect of further quantitative easing in the U.S. led to depreciation of the U.S. dollar and encouraged fund flows into commodities. Finally, Mount Gibson Iron rallied in advance of a quarterly report that ultimately delivered strong ore production, solid sales and strong exploration targets.

Exposure to the Banks sector hurt performance a little as the portfolio was overweight ANZ Banking Group (-1.4%) and National Australia Bank (-6.5%). The big four banks lost ground as the Government flagged bank reforms in response to increases in standard variable mortgage rates above the increase in the target cash rate. We note that both ANZ and NAB announced strong results early in the quarter. Our preference is for these "business banks" as they are better positioned for profit growth than the more retail focused banks at the current, elevated interest rates on deposits.

Outlook

We remain favourably disposed to Australian equities at this time as improved corporate earnings, strong balance sheets and favourable underlying economic fundamentals should allow the Australian equity market to move higher on a medium term view.

Abundant cash levels in corporate Australia should lead to higher dividends, merger and acquisition activity, capital expenditure and strong employment levels. This further underpins the case for Australian equities at this time.

In respect of stock specific investment opportunities, we continue to observe a valuation spread between the most attractive and least attractive stocks in the investment universe that is well above historical averages. This signals to us that opportunities for stock selection are abundant and that active management should be handsomely rewarded.

Further Information

Portfolio Characteristics

Number of securities at period end	51

Sector Allocations	Active %
Metals & Mining	+1.9
Materials ex Metals & Mining	+2.1
Energy	-3.0
Consumer Staples	-1.5
Consumer Discretionary	+4.4
Industrials	-0.6
Health Care	-3.3
Telecommunication Services	-2.5
Information Technology	-0.6
Banks	+5.0
Financials ex Banks & Property	+1.4
Property	-3.1
Utilities	-0.2

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