LEGG MASON
GLOBAL ASSET MANAGEMENT

Legg Mason
Tactical Allocation Trust

Objective

The Legg Mason Tactical Allocation Trust aims to achieve a rate of return in excess of its benchmark over rolling three year periods by making active asset allocation decisions between Australian equities, bonds and cash.

Legg Mason continually assesses the relative values of Australian equities, bonds and cash. The portfolio is tilted toward the relatively undervalued asset class in the expectation that the undervalued asset class will outperform as it returns to its assessed fair value.

Benchmark

50% the S&P/ASX 200 Accumulation Index and 50% the UBS Australian Treasury Index.

Value

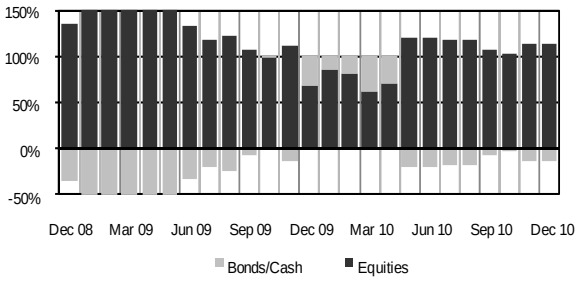
$80,321,430.

Performance (before fees and taxes)

	Trust %	Benchmark %
3 months	5.39	1.83
1 year	7.18	3.73
3 years p.a.	1.59	1.40
5 years p.a.	3.58	5.32

Past performance is no indication of future performance.

Asset Allocations



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.

In the Australian bond market, the yield on Australian 10-year government bonds rose 0.55% over the quarter to 5.51%.

Activity

The Legg Mason Tactical Allocation Trust started the quarter overweight Australian equities (+107.4%) and underweight Australian bonds (-7.4%).

The Australian equity market was relatively stable over the quarter, though it did gain some ground on improved investor sentiment. Meanwhile, 10-year bond yields were ended the period higher.

The size of the market movements triggered a number of small asset allocation switches between Australian equities and bonds. All of the asset allocation switches were on the overweight equities and underweight bonds side of the neutral benchmark allocation.

The portfolio's equity allocation ended the quarter a little higher at +113.4% (bonds -13.4%). The portfolio is positioned to benefit from an expected return to more normal relative equity and bond market valuations.

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In the portfolio's bond allocation, portfolio duration began the quarter 0.14 years longer than benchmark duration. During the quarter, the portfolio's duration position was actively managed in response to changes in 10-year bond yields. The portfolio's bond allocation ended the quarter with duration 0.33 years longer than the benchmark.

Performance

The Legg Mason Tactical Allocation Trust outperformed its benchmark by 3.6% over the quarter. Trust performance over the past year was 3.4% ahead of benchmark.

Performance this quarter was aided by the portfolio's significant overweight allocation to equities and underweight allocation to bonds, as the equity market outperformed the bond market.

Further, security selection in the portfolio's Australian equity allocation also aided performance this quarter.

Meanwhile, duration management within the portfolio's bond allocation had a negligible impact on portfolio performance.

At 31 December 2010, the assets of the Legg Mason Tactical Allocation Trust were invested as follows:

	Trust %	Benchmark %
Australian equities	+113.4	+50
Australian bonds	-13.4	+50

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