

Legg Mason Australian Bond Trust

Objective

The Trust aims to earn a before fees and taxes return of 0.75% p.a. in excess of the benchmark over rolling three year periods.

Benchmark

UBS Australian Composite Bond Index.

Value

\$216,516,670.

Performance (before fees and taxes)

	Trust %	Benchmark %
1 month	1.15	1.37
3 months	3.44	3.60
1 year	12.77	7.86
3 years p.a.	8.05	7.67

Past performance is no indication of future performance.

Profile

Attribution	Basis Points
Duration	-5
Yield curve	0
Sector selection	+3
Security selection	-19
Residual	-1

Sector Allocations	Trust %
Government	28.0
Supranational	9.0
Corporate investment grade	45.7
High yield	0.7
Mortgage and asset backed	3.8
Index linked	1.3
Banking government guaranteed	10.1
Cash and cash equivalents	1.4

Market Review

Economic growth momentum appeared to soften during the month as March quarter gross domestic product data released in early June showed economic activity grew at 0.5%, compared with 1.1% the prior quarter. Confidence and building approval measures also declined. However the unemployment rate provided some positive news with a fall to 5.2%.

The Reserve Bank of Australia kept the target cash rate at 4.5%. Softer economic data, heightened sovereign risk aversion and the Reserve Bank's assessment that borrowing rates were back to average appeared to contribute to this decision. Bank bill rates increased through the month to levels not seen since November 2008.

Domestic government bond yields inched higher through most of June before market sentiment darkened and yields declined sharply at the end of the month. The decline in yields late in the period was driven by offshore leads as the U.S. and other international bonds rallied on weaker economic data, including a downward revision of March quarter gross domestic product.

Credit spreads on highly rated corporate bonds remained largely unchanged while spreads on lower rated investment grade debt widened. This caused lower rated credit to underperform. Domestic debt issued by Australian based corporates tended to outperform their international peers.

Currency volatility continued as concerns of weaker than expected global growth resurfaced. The Australian dollar finished the month even to slightly down against most major currencies.

Performance

The Legg Mason Australian Bond Trust marginally underperformed its benchmark over the month. However, performance over the past year was 4.9% ahead of benchmark.

Portfolio duration remained short relative to benchmark duration during the month. This provided a positive contribution to performance for much of the month. However, the sharp decline in bond yields late in the period reversed the gains to finish the month as a detractor from portfolio performance.

Credit spreads were generally less volatile than the outright bond market, with the exception of Loy Yang, which detracted from portfolio performance along with RBS and Orica. This was partly offset by the excess running yield from the portfolio's overweight to the corporate sector. Spread tightening by Wells Fargo and Macquarie contributed positively to performance.

Outlook

Domestic gross domestic product growth is expected to move towards trend in 2010/11. As government stimulus begins to wind down, a self sustaining growth phase is expected to ensue.

Inflation is forecast to remain in the upper band of the Reserve Bank's target range and may push above the band over the short-term due to one-off items. High inflation is expected to continue to pressure the Reserve Bank as strength in the mining sector may lead to wage and cost pressures, as witnessed in 2007/08.

With Australia's labour market in very good shape and broader economic growth strengthening, cash rates are expected to continue to move higher throughout 2010, with an expectation that rates could reach around 5% by the end of the year.

Portfolio duration is expected to be tactically managed as volatility is likely to remain high while markets debate the speed of the global recovery, the possible return of inflation and sovereign risk issues.

The portfolio maintains an overweight position in corporate bonds, with emphasis on Financials, as market valuations and increased regulation provide significant appeal despite spreads tightening over the past year. We are also selectively buying primary corporate deals in industries that will benefit from an economy that has returned to growth and in those that have de-leveraged, namely property trusts and infrastructure.

We also maintain an overweight position in government guaranteed bank issuance as a defensive strategy. This issuance offers the assurance of the Commonwealth Government with a relatively attractive yield. The portfolio maintains an underweight exposure to government bonds as they remain relatively expensive.

Further Information

Portfolio Characteristics

Duration (years)	3.3
AAA	50.9
AA	13.4
A	24.7
BBB	9.1
Below BBB	1.9