

Legg Mason Australian Small Companies Trust

Objective

The Trust aims to earn a before fees and taxes return of 5% p.a. in excess of the benchmark over rolling three year periods.

Benchmark

S&P/ASX Small Ordinaries Accumulation Index.

Value

\$120,010,857.

Performance (before fees and taxes)

	Trust %	Benchmark %
1 month	-3.53	-3.73
3 months	-10.32	-11.59
1 year	24.09	11.18
3 years p.a.	-8.99	-14.20

Past performance is no indication of future performance.

Profile

Value Added	Active Weight %	Monthly Return %	Monthly Alpha %
Flexigroup	+3.0	+12.3	+0.4
Mineral Resources	+2.3	+16.4	+0.4
Campbell Brothers	+3.2	+6.3	+0.4
ISOFT Group	-0.1	-70.4	+0.3
Boart Longyear	+3.7	+3.3	+0.3

Value Detracted	Active Weight %	Monthly Return %	Monthly Alpha %
Elders	*-0.2	-61.6	-1.2
Transpacific	+1.7	-16.7	-0.3
Pacific Brands	+2.4	-12.8	-0.3
Riversdale Mining	-1.5	+11.9	-0.2
Perseus Mining	-0.9	+21.4	-0.2

*Portfolio was overweight Elders intra-month.

Market Review

Equity markets around the world lost ground during June due largely to investors continued concerns over European sovereign debt levels and moderate relative growth expectations in China and the U.S. Domestically, wrangling over the Resource Super Profits Tax continued to generate headlines, though Materials companies were not uniformly lower.

The Australian small companies market closed down 3.7% over the month, as measured by the S&P/ASX Small Ordinaries Accumulation Index. Broadly speaking, investors reduced their exposure to cyclical securities this month. Over the past year, Australian small companies gained 11.2% despite the recent declines.

Corporate announcements continued to drive stock specific performance outcomes this month. Riversdale Mining (+11.9%) tracked higher as it announced that it had signed a non binding memorandum of understanding with Chinese group Wuhan Iron and Steel for the development of the Zambeze Coal project in Mozambique. Meanwhile, Mineral Resources of Australia (+16.4%) outperformed as it extended its takeover offer for Mesa Minerals.

Elsewhere, gold stocks were mostly higher as the price of gold continued to rise amongst the backdrop of heightened global risk aversion. Avoca Resources (+33.0%), Perseus Mining (+21.4) and Kingsgate Consolidate (+13.1%) were all higher.

On the economic front, the Reserve Bank of Australia left the target cash rate at 4.50%, while the Australian dollar gained some ground against the U.S. dollar, gaining US0.33 cents to finish the month at US85.23 cents. March quarter gross domestic product recorded a 0.5% gain, in line with market expectations.

Performance

The Legg Mason Australian Small Companies Trust outperformed its benchmark by 0.2% over the month. Portfolio performance over the past year was 12.9% ahead of benchmark. At the sector level, portfolio exposure to the Industrials, Health Care and Information Technology sectors added the most value.

In the Industrials sector, portfolio overweight exposures to Mineral Resources of Australia (+16.4%) and Campbell Brothers (+7.9%). Mineral Resources of Australia gained ground on the aforementioned extension of its takeover offer for Mesa Minerals, while Campbell Brothers gained ground as it announced upgraded profit guidance for the first half of 2011. The firm cited strong trading conditions for the majority of the company's operations.

Exposure to the Health Care sector aided performance as the portfolio was overweight Qrxpharma (+5.4%) and not hold iSOFT (-70.4%). Qrxpharma, clinical stage specialty pharmaceutical company, gained ground as investors favoured the defensive nature of the Health Care sector, while iSOFT was significantly lower as it announced a weak trading update.

Meanwhile, portfolio exposure to the Information Technology sector added value as the portfolio's overweight exposures to SMS Management & Technology (+4.8%) and Melbourne IT (+2.9%). Information Technology stocks generally performed well compared to the some of the more highly levered Consumer Discretionary and Industrials names. Our view is that investors have been too pessimistic about the prospects of selected Information Technology companies; examples include SMS Management & Technology and Melbourne IT.

Finally, being overweight Flexigroup (+12.3%) in the Financials sector was also beneficial to portfolio performance as the stock continued to outperform post the completion of a rights issue in March.

The only significant detractor from portfolio performance was the portfolio's overweight exposure to Elders (-61.6%). We had initiated an overweight position in this company as the company was well capitalised, we had a favourable view of the new management team and a good crop planting season was apparent. However, the firm announced during the month that it had downgraded underlying profit due to a lower fertiliser price and other factors. We have since liquidated our holding in this company.

Outlook

Our view is that the recent market weakness is significantly overdone and that it may partially be explained by memories of 2008, when investors that were slow to factor in the impact of the global financial crisis were hit hard.

We maintain that there remains significant value on offer in selected underlying Australian small company securities and that the sector should be able to move higher on a medium term time horizon. This view is supported by evidence that a number of small companies have reduced their risk profiles over the past year. As such, a number of firms are poised to produce strong margin expansion once revenue growth returns.

Stock specific developments are likely to be a critical driver of Australian equities over the remainder of 2010, as the valuation spread between the most attractive and least attractive names in the investment universe remains significantly higher than their historical averages. As such, we have positioned the portfolio to benefit from stock specific opportunities and we continue to expect to produce above normal portfolio returns over the medium term.

Further Information

Overweight Positions	Active %
Bradken	+3.9
Henderson Group	+3.7
Boart Longyear	+3.7
Flight Centre	+3.6
Campbell Brothers	+3.2

Underweight Positions	Active %
ResMed	-2.1
Ramsay Health Care	-1.9
Macarthur Coal	-1.7
Riversdale Mining	-1.5
Aquila Resources	-1.3