

# Legg Mason Brandywine Global Fixed Income Trust

## Objective

The Trust aims to earn a before fees and taxes return of 2% p.a. in excess of the benchmark over a complete market cycle of three to five years.

## Benchmark

Citigroup World Government Bond Index, hedged into Australian dollars.

## Value

\$83,555,235.

## Performance (after fees, before taxes)

	Trust %	Benchmark %
1 month	1.25	0.93
3 months	2.52	3.77
1 year	14.26	9.19
2 years	10.19	9.95

Past performance is no indication of future performance.

## Profile

### Portfolio Characteristics

Average modified duration (years)	7.0
Average credit quality (Standard & Poor's)	AA-

### Sector Allocations

	%
Government sovereign	51.8
Government regional agencies	8.8
Municipal bonds	2.0
Corporate bonds	23.1
Mortgage backed securities	6.9
Cash and currency	7.4

## Market Review

### Developed Global Bond Markets

Global bonds continued their rally during July although the gains were generally smaller and more selective than we have seen recently. The rally probably slowed based on reduced fears that had plagued financial markets during 2010. First and foremost, the threat of a European Monetary union break-up became even more unlikely since European politicians and the European Central Bank seem to have stabilised the situation through the combination of a European Union bailout package and European Central Bank intervention into peripheral European bond markets. In fact, these peripheral bond markets were the best performed during July as spreads between Spanish, Portuguese, Irish and Italian government bonds narrowed sharply against German government bonds. These four bond markets turned in solid gains while at the same time German government bonds actually fell in price and Germany was one of the worst performed benchmark countries. Other weak performed government bond markets included Sweden, the United Kingdom and Australia. This is perhaps to be expected considering that these three economies have recently surprised on the upside. Another concern that has been weighing on markets this year is the emerging economic slowdown in China. While last month's data did not show a turnaround in direction, the rate of slowing does appear to have declined and Chinese policymakers indicated that they are close to the end of their recent tightening measures. This news, plus the improvement in Europe, was enough to offset new slowing in the United States and helped to spark a strong rally in global risk assets, particularly equities. Taken together, it is somewhat surprising that most global government bond markets were able to finish July in the black, but the strong performance of bonds is a testament to the fragility of the global recovery and the absence of inflationary pressures in most of the developed world.

### Currencies

The U.S. dollar ended July broadly lower. A steady weakening of U.S. economic data and a still anaemic credit backdrop has created more widespread fears over the potential for a double-dip recession in the U.S. Furthermore, even if U.S. growth manages to stay positive for the rest of 2010, many believe that inflation is set to turn negative, including core measures, which could easily result in the U.S. Federal Reserve resuming quantitative easing. This range of possible outcomes, from negative growth through core deflation to possible additional quantitative easing, are all U.S. dollar negative so July saw currency investors react by selling U.S. dollars across the board.

The fact that these renewed fears about the U.S. economy happened to coincide with positive political and economic developments in Europe meant that European currencies were many of the best performed during July. In addition, the aforementioned worries concerning core deflation in the U.S. and more quantitative easing by the U.S. Federal Reserve (which would lead to lower interest rates in the U.S.) helped higher yielding currencies outperform.

Specifically, the best performed major currencies during July were the Polish zloty (up 10.4%), Swedish krona (up 8.1%), Australian dollar (up 7.5%), and Norwegian krone (up 7.0%). The laggards were the Japanese yen (up 2.3%), Mexican peso (up 2.3%), Singapore dollar (up 2.9%), and South Korean won (up 3.3%). There were no major currencies down against the U.S. dollar in July.

We will continue to closely monitor growth and inflation developments within the U.S. Currently we still expect the U.S. recovery to continue and inflation to remain modestly positive, however, if this view changes we will be quick to reallocate the portfolio accordingly.

### Corporate Bonds

U.S. corporate bonds were mixed during July. Higher quality corporate spreads narrowed thanks to robust fundamentals, which should help to offset a weaker economic environment. Also, the continued search for yield by bond investors played a role with U.S. treasury securities trading at historically low yields. On the other hand, below investment-grade corporate spreads widened in response to the weaker activity data in the U.S. since this segment of the market is generally more dependent upon strong economic growth for profitability. In summary, A-rated 10-year U.S. corporate bond spreads narrowed 0.10% to end July at 1.66% over 10-year U.S. Treasury securities. Meanwhile, B-rated 10-year U.S. corporate bond spreads widened 0.21% to 6.84% over 10-year U.S. treasury securities. Our view that U.S. growth will remain positive throughout the second half of 2010 combined with the attractive valuations on many corporate bonds and the overall health of U.S. investment-grade corporate balance sheets keeps us overweight U.S. investment-grade credit for the time being.

### Mortgage Bonds

There was positive news on the housing front. The Case-Shiller 10-city index for May rose 1.2% compared with April while the 20-city index rose 1.3%. When adjusted for seasonal factors, both the 10-city and 20-city reading increased 0.5%. From a year earlier, the 10-city index rose 5.4% and the 20-city reading climbed 4.6%. The S&P Case-Shiller home-price indexes showed home prices were boosted in May by seasonal factors and the residual impact of the expired first-time home buyers tax credit.

### Emerging Markets

Emerging markets performed well in July, in keeping with the general rally in risk assets throughout the world. The fact that most economic growth is currently found within the emerging markets, while at the same time they generally offer reasonably valued or under-priced currencies and bond markets with high real yields, helped this area of the global bond market to outperform. Our particular holdings rallied in July along with the rest of the sector. Specifically, with respect to foreign exchange, one of our more recent positions, the Hungarian forint, had an excellent July and gained 7.1%. The Turkish lira also rallied as it closed July higher by 5.1%. The Brazilian real rose 2.8% and the Indonesian rupiah gained 1.4%. Perhaps the rupiah underperformed thanks to the already strong 2010 it has had. Our bond holdings also performed well. Hungarian government yields fell 0.43% to 7.23%, Brazilian yields dropped 0.36% to 12.03% and Indonesian government bonds fell in yield by 0.30% to end July at 8.08%. All in all it was a great month for emerging market assets as they generated significant absolute returns. Growth momentum is still strong within the emerging markets and valuation tends to be reasonable, therefore we expect to maintain positioning here for the time being. Additionally, recent developments within each of the countries where we are invested have been supportive for financial markets and argue that we should stay the course with these allocations.