LEGG MASON
GLOBAL ASSET MANAGEMENT

Legg Mason
Emerging Market Trust

Objective

To earn a before fees and taxes return of 3% p.a. in excess of its benchmark over a complete market cycle of three to five years.

Benchmark

MSCI Emerging Markets Index, expressed in Australian dollars.

Value

$191,709,780.

Performance (before fees and taxes)

	Trust %	Benchmark %
1 month	2.96	1.08
3 months	1.09	0.85
1 year	12.35	10.13
3 years p.a.	-4.35	-3.35

Past performance is no indication of future performance.

Profile

Regional Allocations	Trust %	Benchmark %
Europe / Middle East / Africa	18.1	20.4
Asia	58.2	56.9
Latin America	22.0	22.7
Cash	1.7	-

Sector Allocations	Trust %	Benchmark %
Energy	14.1	13.6
Materials	14.0	14.1
Industrials	5.6	6.8
Consumer Discretionary	7.8	6.3
Consumer Staples	5.2	6.6
Health Care	0.9	2.3
Financials	26.7	25.4
Information Technology	13.4	12.9
Telecommunications	9.6	8.3
Utilities	1.0	3.7
Cash	1.7	-

Market Review

After a relatively poor June quarter, emerging markets rebounded in July with a return of 1.1%, as measured by the MSCI Emerging Markets Index, expressed in Australian dollars. Markets were supported by better than expected earnings results, improved outlooks from many U.S. companies and encouraging economic data out of Europe. In addition, China's tightening measures appear to have had their intended effect of slowing the economy.

Europe/Middle East/Africa

Economic releases out of Russia pointed to some rebound in economic activity as retail sales as well as investment and employment data was better than expected. However, industrial output remained weak. Meanwhile, the focus shifted to the impact of the wildfires that ravaged part of Russia and led to sharp cuts in Russian grain crop production estimates. Finally, the government has put forward an ambitious privatisation plan aimed at covering part of the budget deficit.

South Africa economic indicators pointed to a mild loss of momentum as retail sales growth and manufacturing production slowed. Overall, the central bank remained confident in its inflation outlook and kept interest rates unchanged at 6.5%.

In Turkey, inflation decelerated and once again it surprised on the downside, thus validating the central bank's dovish monetary policy stance. Domestic demand growth gathered momentum and it should remain well supported in coming quarters as credit expansion continued to respond to the low interest rate environment. As a consequence of the strong growth environment, Turkey's current account deficit widened.

Asia

The Reserve Bank of India reacted forcefully to strong inflationary pressures as it raised interest rates twice during the month. Though inflation readings remained high, the latest developments on the monsoon front indicated that rainfalls have now recovered. This should help relax some food price pressures. Finally, industrial production decelerated more quickly than anticipated.

In Korea, economic activity remained robust. Against this background, the Bank of Korea raised interest rates and highlighted the inflationary risks associated with strong growth. However, given the perceived fragility in global demand, the central bank is likely to take a gradual approach to further policy normalisation.

Chinese economic data confirmed a slowdown. There was a steady deceleration in industrial production and fixed asset investment growth, while consumer indicators remained robust and exports surprised on the upside.

Indonesian economic growth exceeded expectations, driven by a rapid expansion of domestic demand. At the same time, inflation gathered momentum. Despite the strong domestic demand growth picture and signs of accelerating inflation, Bank Indonesia left rates unchanged.

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Latin America

Brazil benefited from the rebound in commodity prices and from the central bank's signals that the cycle of interest rate increases would pause for now given the deceleration in economic activity and the parallel reduction in inflation risks. On the data front, industrial production, retail sales and job creation were all below expectations for May and June.

Mexico's economic activity came in above expectations: gross domestic product rose, retail sales improved and industrial production expanded on improved manufacturing output. The central bank remained comfortable with the inflation outlook and kept interest rates on hold.

Performance

The Legg Mason Emerging Market Trust significantly outperformed its benchmark over the month. Portfolio performance over the past year was 2.2% ahead of benchmark.

During the month, the portfolio's overweight exposure to Brazil contributed positively to performance as the market outperformed the broader index. From a sector perspective, portfolio exposure to the Consumer Discretionary and Industrials sectors added value over the month.

At the stock selection level, holdings in Brazil (Banco Itau, Cyrela Brazil Realty, TAM) and Taiwan (HTC, Acer) contributed positively to the performance of the portfolio.

Outlook

The global economy is at an inflection point. Going into the second half of 2010 and 2011, global growth is likely to decelerate from the rapid rates observed during the last few quarters as the effects of restocking and fiscal policy support fade out and growth converges to trend levels. In this post-recovery environment, emerging markets are expected to be leading contributors to global economic growth due to robust domestic demand dynamics and sound policy mixes. Overall, we believe that the global macroeconomic environment will remain supportive for emerging markets' earnings growth, as a substantial proportion of the asset class' earnings power is geared towards domestic demand growth.

Despite the oncoming global growth deceleration, we still expect emerging market equities to deliver positive returns in the next one to two years. From a fundamental perspective, emerging market earnings expansion should be well supported by strong domestic demand growth across most regions, while inflation - which is already rising in most countries - is far from calling for drastic action by emerging market central banks. At the same time, following the recent bout of market volatility, valuations are at relatively attractive levels.

In terms of risks, we believe it is unlikely that we will see a repeat of the seizure of the global financial system akin to the one following the collapse of Lehman Brothers in 2008. Therefore, our base case remains for a continued cyclical recovery in the world economy and not the double dip scenario that many investors fear.

Markets may well remain volatile in coming quarters as Europe's fiscal troubles are far from over and negative headlines emanating from the region are likely to continue. In this context, we believe emerging market equities may remain range-bound as strong asset class fundamentals and attractive valuations are offset by negative sentiment towards risky assets in general.

On the portfolio side, our recent moves have been driven by a combination of responding to valuation opportunities arising from higher volatility and recycling gains from stocks where our thesis has broadly played out into new alpha ideas. As a net result, we have increased our exposure to Indonesia and Brazil, and reduced exposure to Mexico, India and Thailand.

As we come into the middle of the year our portfolio is overweight in Russia, Indonesia and Thailand and underweight in Malaysia, Taiwan and Korea. Our larger positive sector exposures are in the Telecommunications, Information Technology and Energy sectors while a negative sector tilt is in place in Utilities, Consumer Staples and Industrials.