

Legg Mason Global Multi Sector Bond Trust

Objective

To maximise total return through income and capital appreciation.

Comparative Index

The Trust does not formally measure its performance against a benchmark. However, for the purpose of illustrating the Trust's performance, the Trust may state its investment performance against the Comparative Index.

The Trust's Comparative Index comprises 50% the Barclays Capital Global Aggregate Index, 25% the J.P. Morgan Emerging Markets Bond Index Plus and 25% the Barclays Capital U.S. Corporate High Yield Index (all hedged into Australian dollars).

Value

\$19,857,798

Performance (before fees and taxes)

	Trust %	Comparative Index%
1 month	-1.06	-0.57
3 months	0.40	0.79
1 year	5.55	9.10
3 years p.a.	18.20	17.30

Past performance is no indication of future performance.

Profile

Portfolio Characteristics

Effective duration (years)	5.3
Average credit quality (Standard & Poor's)	BBB+

Sector Allocations	%
Government	22.0
Investment grade	17.1
Mortgage and asset backed	3.6
High yield	24.3
Emerging markets	26.6
Inflation protected securities	0.0
Cash and other securities	6.4

Market Review

The positive sentiment that characterised much of October quickly disappeared in November after the Greek Prime Minister George Papandreou threatened to hold a referendum on the latest EU bailout. Investors continued to question whether European policymakers had the tools required to ring-fence further contagion and whether they had the resolve to confront the difficult decisions they have been postponing for years. The speed at which the European debt crisis escalated had left investors largely ignoring developments in Greece, given its relatively small size of outstanding debt in the context of overall eurozone GDP.

However, by throwing into the Greek public domain the October deal that European policymakers had spent significant time orchestrating, Papandreou had pushed the leaders of Germany and France one step too far and the referendum was quickly called off. This was followed in quick succession by Papandreou's resignation and the formation of a new, technocratic government led by former European Central Bank (ECB) Vice-President Lucas Papademos. Italy also installed a technocratic government. Investors shed riskier assets in preference of liquidity and safety as they contemplated what would have been an unthinkable question only a year ago: how much longer will the euro survive in its current form?

Economic data deteriorated significantly in Europe and most forecasters have pencilled in at least a mild recession in the next few quarters. Growth is slowing sharply, even in Germany, where job creation came to a standstill and the unemployment rate ticked up for the first time in over two years. The ECB responded by cutting its policy rate by 25 basis points (bps) and signalled likely additional rate cuts at future meetings.

Economic conditions outside of Europe were generally better and it looks like the US will continue to grow at a modest pace for the next few quarters, supported by a US Federal Reserve that remains focused on growth, with a number of officials recently articulating the need to do more on the policy front. In the UK, the Bank of England also signalled that its asset purchase programme would continue and perhaps even be expanded to help support weakening economic activity.

US Treasury 10-year bond yields declined by 5bps, returning 1.1% when hedged into Australian Dollar, while the German 10-year bund yield increased 25bps. The increase in bund yields largely occurred over the course of two days, triggered by a failed auction in which the Bundesbank had to retain a portion of the issuance to make up for insufficient private sector demand. Spreads on peripheral sovereign debt continued to widen, with the yield on Italian five-year issues reaching more than 6.3% over equivalent-maturity German bunds, an increase of nearly 170bps over the last month.

Investment-grade credit spreads widened 40bps in the US and 75bps in Europe, with financial issuers leading the underperformance. High-yield spreads widened 65 bps in the US, returning -2% in the month. European high yield was more volatile, losing around 4%. The euro depreciated against the US dollar by 3.6%, while oil prices rose nearly 8%. Emerging market (EM) currencies were also generally weaker by 3% to 4% versus the US dollar. EM credit underperformed sovereign debt, returning -1.5%.

Performance

The Legg Mason Global Multi Sector Bond Trust underperformed its benchmark by 0.5% over the month.

The overweight to financials, higher beta high yield names and exposure to local EM debt and EM credit were the primary detractors.

In terms of investment strategies, the fund continues to buy non financial investment grade corporate issues via the primary market. In addition, US Dollar denominated EM sovereign and corporate debt was added, given more attractive valuations post the sell-off in the third quarter. The fund also added more US treasury duration as a hedge against more European led contagion.

In terms of local EM, positions were adjusted further, including trimming Mexican Peso as further volatility is expected. The short positions in Hungarian Forint and Polish Zloty were eliminated, as these countries are likely to be further impacted by the uncertainty in Europe.

Outlook

It looks like political leaders within the eurozone will soon have to confront the difficult decisions that they have been postponing for years. There is little that Italy—or Spain, for that matter—can do unilaterally to reverse the vicious cycle that it has found itself in since the early summer. Aggressive fiscal austerity will only slow growth further, pushing risk premiums higher. Alternatively, looser fiscal policy will aggravate Italy's debt trajectory, again with much the same effect. Either way, Italy's borrowing costs will not decline from the current threatening levels unless an agreement on a European-wide institutional solution is reached. This could include far greater intervention by the ECB, European Financial Stability Facility or International Monetary Fund. We remain cautious and have not added to risk positions despite the significant increase in compensation for holding these positions.

As year-end approaches, credit-market liquidity remains poor; hence, we continue to look for ways to mitigate portfolio risk using other strategies, via currencies, duration or yield curve positions, with our primary focus being to ensure a balance of risks in the portfolio. To balance the portfolio, we are focusing on select financial issuers, predominantly those domiciled in the US, where the banks have made significant progress to shore up their core Tier-1 capital ratios and have less exposure to the European periphery. Our overweight to select financial issues is not only driven by current extreme

valuations (where spreads are much higher) but also, more importantly, our view that the sector should benefit from ongoing deleveraging and tighter regulatory oversight.

We will continue to add to industrial and utility sub-sectors, while we maintain an underweight to agency mortgage-backed securities. We continue to run a modest bias to high-yield bonds, focusing on non-cyclical sectors, as well as on those issues that continue to improve their balance-sheet metrics and that could be a target for an upgrade or experience positive event risk in coming quarters. In addition, we favour bank loans given their senior status in the capital structure.

Finally, a number of EM currencies are compelling both for their appreciation potential and their role as a diversifier. These currencies include the, Malaysian ringgit, Brazilian real and Mexican peso, although we have reduced this allocation recently given heightened market volatility.