# Client Update

## Legg Mason Property Securities Trust

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## About the Legg Mason Property Securities Trust

The Legg Mason Property Securities Trust ("the Trust") is designed to add value for our clients by capturing the competitive edge of our highly experienced Listed Property specialists. The A-REIT team and the wider Legg Mason Australian Equities group are distinguished by thought leadership in our fundamental research.

The Trust exploits:

- The value anomaly, whereby undervalued companies have shown to outperform over the long term.
- The insights of our expert analysts into A-REIT earnings power and access to quality informational sources.
- A lack of behavioural biases evident in other market participants compared to our disciplined research driven investment process.
- Tax advantages from low turnover and where relevant our explicit valuation of franking benefits to investors.
- Substantial AUM capacity such that our insights are not eaten up by transaction costs, unlike the "brand" managers.
- A market valuation spread opportunity that will generate far greater than average returns from this strategy over the next two to five years.

Most importantly, the product captures the benefits of an experienced, motivated and cohesive investment team. Ultimately, the insights of our experienced analysts matter and are an important source of competitive edge.

## Strong recent performance…

Recent A-REIT total returns have been driven by attractive valuations, lower gearing and a return to more traditional rental streams. Importantly, since early March 2009, performance of the Trust has been much improved on both an absolute and relative to benchmark basis, as highlighted in the table below.

Gross of fees and tax investment performance

| | March 2009 | April 2009 | May 2009 | 3 mths to May 09 |
|---|---|---|---|---|
| Legg Mason Property Securities Trust | 3.6% | 7.6% | 9.1% | 21.7% |
| Benchmark[1] | -0.0% | 6.1% | 3.8% | 10.1% |
| Excess Return | 3.6% | 1.6% | 5.3% | 11.6% |

1 S&P/ASX 200 A-REIT Accumulation Index
Past performance is no indication of future performance

The market dislocation experienced during 2008 produced large valuation anomalies. A key driver of the recent outperformance has been overweight allocations in some slightly riskier property names which have outperformed as investors have become more risk tolerant. We have also benefited from an underweight exposure to some of the perceived "safe haven" names. Our view is that investors were paying too much for some of these defensive REITS. The bottom line is that sentiment towards equity and property markets has improved and we are again seeing a value oriented approach rewarded.

## A Turbulent Ride…

Australian listed property securities, or A-REITs, have certainly given investors a turbulent ride recently. While strong returns were enjoyed through to late 2007, the global financial crisis engulfed investment markets during 2008 and REIT markets around the world have suffered dramatically.

With this backdrop, following solid outperformance of its benchmark over one, three, five and ten years to 31 December 2007, the Legg Mason Property Securities Trust underperformed the benchmark during 2008, which saw the Australian property securities market decline 54.0%, underperforming the broader Australian equity market by 15.6%.

It is worth taking a moment to examine precisely what has driven significant divergence of returns within the A-REIT sector, both on the way up and on the way down. Of equal importance, we also share our views on the outlook for both our Trust and the wider A-REIT market – which simply put looks very attractive.

## Debt, Debt, Debt…

In the lead up to the global financial crisis, total returns were driven by three themes. The sector benefited from cap rate compression (rising asset prices), increasing leverage into that rising price environment and a focus by the A-REIT market upon non-rental based business models.

As we entered the credit crisis, and with it encountered the dramatic reduction in the availability of debt the A-REIT sector could call upon, these three themes reversed and did so at considerable speed. Accordingly, sizeable cap rate expansion (falling prices) and large scale de-leveraging were the main drivers of market performance from late 2007 until early 2009. The other fallout from the global credit crunch saw risk aversion move to extreme levels during 2008.

Over this period, two key factors drove the Trust's relative performance.

- Firstly, within the Australian property securities market, a "flight to safety" saw the lower leveraged, domestic focussed names outperform on a relative basis. During this period the Trust was broadly neutral to leverage versus the benchmark (as opposed to underweight), which detracted value.
- Secondly, our investment process focuses on identifying the intrinsic value of underlying property securities. Given our structured and disciplined investment process, when the difference in the assessed "fair values" of securities is wide enough, a trade is implemented. Throughout 2008, we continued to see a widening dispersion in our investment signal. The impact of this widening in "fair value" margins meant that we traded some property securities too early.

We have examined portfolio behaviour and made some valuable enhancements to the way we view risk. Our current view is we have seldom been more optimistic or engaged about the return prospects for the Trust.

## What do we expect going forward?

At this point the Australian listed property market is offering attractive total returns, with market valuation anomalies clearly evident. Current implied cap rate spreads to both risk free rates and unlisted property look attractive. Importantly, the reaction by the listed property market to the changed circumstances has been swift, achieved by a return to more traditional rental streams and lower gearing across the sector.

While widening spread dispersion and leverage is all that has mattered during 2008, the flight to the highest quality stocks became extremely crowded. This drove valuation spreads to extreme levels and created significant opportunity for investors willing to buy even small amounts of risk.

As a consequence, we see the opportunity for far greater than average active alpha generation, with the last quarter producing a sizeable turning point. As a result, we are highly optimistic about return prospects going forward.

## For further information please contact:

We would like to take this opportunity to thank you for your loyalty to the Trust through the recent difficult times and look forward to your continued investment support.


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**Legg Mason Property Securities Trust gross performance as at May 2009:**

| | 1 mth | 3 mths | 1yr | 3 yrs p.a |
|---|---|---|---|---|
| Legg Mason Property Securities Trust | 9.1% | 21.7% | -52.8% | -24.5% |
| S&P/ASX 200 A-REIT Accumulation Index | 3.8% | 10.1% | -50.8% | -22.3% |

Past performance is no indication of future performance.