LEGG MASON
GLOBAL ASSET MANAGEMENT

Legg Mason
Australian Core Equity Trust

Objective

The Trust aims to earn a before fees and taxes return of 3% p.a. in excess of its benchmark over rolling three year periods.

Benchmark

S&P/ASX 200 Accumulation Index.

Value

$90,555,516.

Performance (before fees and taxes)

	Trust %	Benchmark %
3 months	-11.89	-11.14
1 year	14.96	13.15
3 years p.a.	-8.78	-7.85
5 years p.a.	4.03	4.52

Past performance is no indication of future performance.

Profile

Overweight Positions	Active %
Seek	+2.3
Henderson Group	+2.3
Rio Tinto	+2.3
News Corporation	+2.3
ASX	+2.3
ANZ Banking Group	+2.3
Amcor	+2.2
Commonwealth Bank of Australia	+2.0
BHP Billiton	+1.6
National Australia Bank	+1.5

Underweight Positions	Active %
Telstra Corporation	-2.4
Westfield Group	-2.2
Woodside Petroleum	-2.1
Woolworths	-2.1
QBE Insurance	-1.9

Market Review

Equity markets around the world lost ground during the June quarter as investors became concerned by European sovereign debt levels and moderating growth expectations in China and the U.S. Domestically, wrangling over the Resource Super Profits Tax generated headlines, though Materials companies were not uniformly lower.

The Australian equity market closed down 11.1% over the quarter, as measured by the S&P/ASX 200 Accumulation Index. Over the past year, Australian equities gained 13.2% despite the recent declines.

Corporate activity continued to gain steam. Newcrest Mining (+6.7%) made an offer for Lihir Gold (+35.2%), Healthscope (+16.1%) announced that various private equity groups were interested in buying the business and Foster's Group (+6.6%) announced that the company would split its wine and beer operations into separate companies.

Meanwhile, Telstra (+8.3%) and the Federal Government announced that they had signed a non-binding Heads of Agreement with respect to Telstra's copper network and associated infrastructure to be sold to the National Broadband Network.

On the economic front, the Federal Budget saw the announcement of a reduced company tax rate, increases to the Superannuation Guarantee levy and a forecast return to surplus by 2012/13. The Reserve Bank of Australia raised the target cash rate by 0.25% to 4.25% in April, while the Australian dollar reaffirmed itself as a “risk” currency; it lost US6.36 cents against the greenback to end the period at US85.23 cents. March quarter gross domestic product recorded a 0.5% gain, in line with market expectations.

Performance

The Legg Mason Australian Core Equity Trust underperformed its benchmark over the quarter. However, portfolio performance over the past year was 1.8% ahead of benchmark. There was scant stock news that impacted portfolio performance this quarter; the underperformance was largely attributable to allocations at the sector level. In particular, performance over the quarter saw value detracted from the portfolio's net exposure to cyclical securities. This negative impact was based on thematic rather than on any significant negative stock specific news.

At the sector level, portfolio exposure to the Consumer Discretionary and Metals & Mining sectors detracted value, while choices in the Consumer Staples and Industrials sectors added back some value.

In the Consumer Discretionary sector, portfolio overweight exposures to Pacific Brands (-40.4%) and Billabong International (-25.7%) detracted from performance. These securities lost some ground as investors sought the safe haven of some of the more defensive consumer names. Billabong was also impacted by a moderation in consumer spending in the U.S., while Pacific Brands also suffered from consensus downgrades and investor concern regarding the current trading environment.

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Our view is that, on a forward looking basis, Billabong's growth strategy remains intact and that the stock is poised to outperform on any consumer rebound. These factors are not reflected in the market price of Billabong, which has been hurt by global risk aversion. In the case of Pacific Brands, the forward looking picture is brighter than its current price would suggest. The company's forecast earnings are strong, their brands remain very attractive and the strategy to control costs should allow it improve margins.

In the Metals & Mining sector, an overweight exposure to Rio Tinto (-16.2%) and an underweight to Lihir Gold (+35.2%) detracted from relative performance. Rio Tinto reported March production a little below investor expectations in most commodities, with iron ore particularly weaker. Further, risk aversion saw a sell off in most exchange traded commodities. Fellow diversified resource stock BHP Billiton (-14.6%) was also lower. In the case or Lihir Gold, the outperformance came on the back of a takeover offer in April from Newcrest, which was followed by a higher bid in May.

Meanwhile, portfolio exposure to the Consumer Staples sector saw contributions to performance from holding Metcash (+4.7%) and Coca-Cola Amatil (+6.1%). In addition to the relatively defensive nature of these stocks, Coca-Cola Amatil affirmed previous guidance of high single digit growth for the first half of 2010 at its May AGM, while Metcash was supported by a solid financial year result announced in June.

Also adding back some value were stock choices in the Industrials sector, where the portfolio did not hold Transurban (-14.2%). Transurban underperformed as it failed to reach agreement with Canadian Pension Plan Investment Board and Ontario Teachers Pension Plan on a takeover.

Elsewhere, being underweight Telstra (+8.3%) detracted value as the stock gained ground on the Heads of Agreement with respect to selling its copper network and associated infrastructure to the National Broadband Network. Though this reduced some uncertainty for Telstra, we remain concerned about the structural decline in fixed line revenues and what its margins will be once the National Broadband Network comes online.

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 equity securities and that the sector should be able to move higher on a medium term time horizon. This view is supported by evidence that Australian firms 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

Portfolio Characteristics

Number of securities at period end	58

Sector Allocations	Active %
Metals & Mining	-1.2
Materials ex Metals & Mining	+3.3
Energy	-2.9
Consumer Staples	+2.0
Consumer Discretionary	+4.2
Industrials	-1.4
Health Care	-2.6
Telecommunication Services	-2.8
Information Technology	-0.7
Banks	+4.0
Financials ex Banks & Property	+0.5
Property	-3.0
Utilities	+0.6