LEGG MASON
GLOBAL ASSET MANAGEMENT

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

$79,504,556.

Performance (after fees, before taxes)

	Trust %	Benchmark %
3 months	3.85	3.53
1 year	17.04	9.18

Past performance is no indication of future performance.

Profile

Portfolio Characteristics

Average modified duration (years)	6.9
Average credit quality (Standard & Poor's)	AA-

Sector Allocations	%
Government sovereign	50.7
Government regional agencies	10.8
Municipal bonds	2.1
Corporate bonds	24.4
Mortgage backed securities	7.6
Cash and currency	4.4

Market Review

Bond Markets

Portfolio duration is slightly above the index level as we think there is some risk of interest rates rising along the yield curve, however most of the risk is concentrated at the short end of the global yield curve. Most of the duration in the portfolio is concentrated in holdings of U.S. corporate and mortgage backed securities.

Last year's returns from holdings of corporate bonds were driven by a combination of the severe dislocation in spreads that existed at the beginning of the year and the aggressive policies of reflation that took place in the U.S. and around the world. Since purchase, portfolio corporate holdings have added more than 3% in alpha relative to owning similar duration in U.S. treasuries. The compression in corporate spreads is very advanced and we have begun a gradual process of reducing exposure, which we expect to continue. Nonetheless, based on historical averages for spread normalisation during economic recoveries, 2010 could provide another 10% of retracement from the extremes.

We continue to believe that valuations are still attractive in the non-agency collateralised mortgage obligation market. We are seeing the first signs of a slowdown in the delinquency pipeline and lower loss severity and expect further upside this year although, as with corporate, not as much upside as we have received in 2009. The main threat to these securities is the housing recovery and, in particular, the foreclosure pipeline. About 5.5 million mortgages are seriously delinquent or in some stage of foreclosure. The speed at which this supply comes on to the market is the key to gauging risk to the housing recovery. We think that the government will do whatever it takes to prevent this supply from overwhelming the market. The recent Home Affordable Modification Program Debt Forgiveness and FHA refinance programs are all consistent with this expectation. The path of mortgage rates will also have a bearing on the housing outlook. The U.S. Federal Reserve is no longer absorbing supply and there are issues concerning the general trend in rates as we noted earlier. Nonetheless, any upward pressure on the general level of rates will coincide with employment and income growth which should overcome at least initially modest increases in borrowing costs.

The portfolio also has significant holdings in long-term U.S. and U.K. sovereign bonds. These securities were originally held throughout 2009 as a hedge against the possibility that our economic scenario might not play out and instead that the world would get what everyone worried about, which was a deflationary depression. Yields have backed up throughout the past five quarters due mainly to the influence of a renormalising economic cycle. As we noted earlier there is still some price risk in these securities going forward. However, we think most of the risk in the yield curve is at the short end.

Corporate Bonds

Our currency strategy remains broadly unchanged, although there have been some noteworthy shifts in the portfolio to position for what we think lies ahead. Within the G3 currencies we remain concentrated in the U.S. dollar, with minimal holdings of yen or euro. We remain constructive on the U.S. dollar because the U.S. economy continues to show strength relative to both the euro area and Japan.

The U.S. Federal Reserve has indicated that rates will remain on hold for a while to come but we believe that there is significant risk at the front of the curve. Conditions could change significantly in the next few months if employment expands as much as we think. The Federal Funds rate, currently close to zero, could close the year somewhere closer to 1% to 2%. In contrast, the Greek debt crisis has propelled Europe towards very tight fiscal policy and sustained easy monetary policy. This combination is usually negative for a currency. Last quarter we highlighted how expensive the euro was relative to traditional benchmarks of value such as real-traded weighted exchange rates and purchasing power parity. The first quarter's plunge in the currency has reduced this overvaluation significantly but it remains above levels we think are consistent with a more neutral price picture. The currency is oversold at the moment and may stabilise or even rebound in coming weeks due to some sort of resolution of the Greek crisis. Nonetheless, the fundamentals remain negative.

Similarly, we continue to shun the yen. Our views on this currency are well known. We have described in detail the full extent of the problem facing public finances. A declining household savings rate means that funding the government's financing will come from corporate savings. A strengthened nominal yen does not help this process. Japan has become more competitive through a brutal process of domestic deflation. However, the new government has continued to press the Bank of Japan to fight deflation. With interest rates already low and fiscal policy stretched, the only real avenue is a weaker nominal exchange rate. The central bank has indicated that it will expand its' quantitative easing operations while other major central banks start to move in the opposite direction.

Outside of these three major currencies the portfolio has exposure to other European currencies by way of the Swedish and Norwegian currencies, the Polish zloty and most importantly the British pound. Our review process indicates that these currencies offer much better intrinsic value relative to the euro.

During the quarter we moved to increase exposure to the British pound further. The U.S. dollar and sterling now represent over half of our currency position. The basis for increasing the holding of sterling is that it represents one of the few global currencies offering good value; the U.K. economy is actually running ahead of the U.S. economy, with house prices rising firmly and employment about to start expanding. The currency has been kept depressed by perceptions that the Bank of England was applying quantitative easing measures more aggressively than the U.S. Federal Reserve and by recent concerns that an indecisive outcome in the upcoming British elections would hamstring efforts to gain control over public finances. In fact, the Bank of England has already suspended further quantitative easing measures and may be forced to move more quickly to reverse policy in view of the upward drift in inflation. Similarly, we think the political will to improve public finances exists on both sides of the British Parliament.

One of our longer-term investment themes has been to underweight the G3 currencies and to overweight currencies in the rest of the world, and in particular several emerging market currencies. Marginal growth in the global economy will come from the emerging middle kingdom of the world and we expect capital to migrate to these areas and bid up their respective currencies.

We noted earlier that many emerging markets have imported U.S. monetary policy via exchange rate policy, which may not have been appropriate. Correspondingly, monetary policy leaders in various markets of the world are beginning to react to strengthening economic conditions which will tend to encourage their currencies higher.

In Asia, our overweight positions are concentrated in the South Korean, Indonesian and Malaysian currencies. These currencies have benefited from the rebound in regional growth stimulated by China. In addition, they are further advanced in the renormalization process.

We remain long the Brazilian Real and Mexican Peso. The latter we anticipate will benefit from the economic cycle affecting the U.S. The former continues to hold interest for its high interest rates and connection to the commodity cycle.

We continue to hold a small overweight in the more traditional commodity currencies: namely, the Australian, New Zealand and Canadian dollars.