

Legg Mason Western Asset Cash Trust

Objective

The Trust aims to earn a before fees and taxes in excess of the return of the benchmark.

Benchmark

UBS Australian Bank Bill Index.

Value

\$55,180,942

Investment Process Summary

The Trust actively manages investments to ensure that:

- Deposits are readily accessible;
- investments are highly liquid and low risk; and
- returns have limited volatility.

Performance (before fees and taxes)

	Trust %	Benchmark %
1 month	0.40	0.39
3 months	1.22	1.21
1 year	5.01	4.89
3 years p.a.	4.46	4.34
5 years p.a.	5.57	5.46

Past performance is no indication of future performance.

Profile

Sector Allocation	Trust %
Bank obligations	73.8
Corporate	0.0
Asset backed	7.2
Cash	19.0

Market Review

Markets rebounded in October from September's depressed levels, but the cautious optimism about European leaders' ability to provide a palatable and sustainable solution to Europe's fiscal and sovereign problems eventually gave way to disappointment. October's gains on risk assets were largely eroded by the end of the quarter.

The Reserve Bank of Australia (RBA) was sufficiently concerned about the downstream effect on Australia's economy that it decided to lower the cash rate by 25 basis points (bps) for first time since April 2009 and followed up with a further 25 bps cut at its December meeting. The cash rate finished 2012 at 4.25% as the central bank indicated that areas outside Europe, particularly Asia, were beginning to feel the economic effects of the European problems. The rate cuts were delivered as the RBA noted that declining inflationary pressures in food, commodities and wages afforded the central bank room to move from a slightly restrictive monetary policy to a marginally accommodative stance.

The broad Australian fixed-income market returned 1.94% for 4Q11, according to the UBS Composite Bond Index, as yields declined across the yield curve and the yield curve flattened in the three- to 10-year range. The 10-year government bond yield hit its lowest level in over 50 years in the last days of December, finishing at 3.67%, well below the cash rate

Domestic credit spreads moved wider over the quarter, and European supranational issuers were scrutinised as much as corporate issuers. Strong running yield on corporate issuers, in particular, significantly reduced the impact of that spread-widening. Equities managed to hold onto a positive return for the quarter, with the S&P/ASX 200 returning 1.2%, having gained as much as 7.2% through the end of October.

The Australian dollar outperformed all major currencies in the December quarter, but remained volatile and traded in a 12-cent range relative to the US dollar, dipping below parity on three occasions as bouts of negative sentiment caused flights to the safety of the US dollar and Japanese yen. The Australian dollar gained 5.7% on the US dollar, and its trade-weighted index gained 4.3% over the quarter.

Performance

The Legg Mason Western Asset Cash Trust returned 1.22% in the fourth quarter of 2011. Portfolio performance remains in line with its benchmark over time.

Outlook

We forecast domestic GDP to grow at around trend level (3.0%–3.5%) in 2012 and 2013. We recognise that the challenges faced in Europe have resulted in slowing economic conditions there and, in turn, pose challenges to broader global growth. However, we are constructive on the US economic recovery (albeit at a slow pace), and recent data have been supportive of this position. We also believe that Chinese authorities have the will and the means to navigate external challenges to China's economy to ensure that growth there remains solid. Such factors are supportive of our domestic growth outlook.

Unemployment is currently hovering at 5.2%–5.3%, but we expect it to drift higher and peak at around 5.5% before edging lower as a large uptick of employment begins to take hold in Western Australia and Queensland due to new projects coming on line. An improvement in sentiment for the rest of the economy should further aid the decline in the unemployment rate through 2012.

Inflation is continuing to drift lower at both the headline and core levels. It no longer poses the risk that it did six months ago, thanks to a slowdown in the non-mining sectors and the restoration of agricultural crops damaged in weather catastrophes in early 2011. The RBA has signalled that it is comfortable with current levels of inflation, which give the central bank the scope to further respond to global challenges, particularly those posed by Europe, should the need arise.

Technical issues have continued to push bond yields deep below the current cash rate and at a level that we consider very expensive, considering fundamentals.

Further Information

Credit Quality	Trust %	Maximum %
"AAA" or "A-1+" securities	86.5	100.0
"A-1" securities and cash	13.5	25.0

Maturity Structure	Trust %
1 to 7 days	14.9
8 to 30 days	18.1
31 to 90 days	52.1
91 to 180 days	14.9
181 to 365 days	0.0

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