

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

\$18,963,348

Performance (before fees and taxes)

	Trust %	Comparative Index%
1 month	2.58	2.11
3 months	4.51	4.33
1 year	7.85	10.86
3 years p.a.	17.85	16.22

Past performance is no indication of future performance.

Profile

Portfolio Characteristics

Effective duration (years)	5.0
Average credit quality (Standard & Poor's)	BBB

Sector Allocations

	%
Government	23.4
Investment grade	18.4
Mortgage and asset backed	3.8
High yield	24.5
Emerging markets	27.9
Inflation protected securities	0.0
Cash and other securities	2.0

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.

Government bond markets performed well, especially in the UK, as risk aversion continued, except for peripheral European government markets, where yields remained high. US corporate spreads remained elevated but ended the quarter unchanged. European corporate spreads widened but rallied into year-end as the ECB acted aggressively in providing liquidity to eurozone banks.

Core measures of inflation were less volatile and continued to moderate across the globe. Curves had become steep as short-dated rates remained anchored. Given the lack of inflationary pressure, central banks would remain on hold. Longer-dated yields would be more sensitive to deteriorating economic conditions. Select financial issues continued to offer attractive prices relative to industry and utility issues. Declining default rates and ample cash would help drive performance in the high-yield sector.

Mortgage spreads did not offer as much compensation as other markets did. Select non-agency mortgage issues continued to look attractive.

Performance

The Legg Mason Global Multi Sector Bond outperformed its benchmark over the quarter.

A long duration position in Europe had a strong positive impact. Curve positioning had a positive impact, driven by an overweight to the 30-year part of the European curve. Spreads narrowed and the high-yield corporate market significantly outperformed.

The euro weakened significantly over the course of the quarter. An overweight to the South Korean won also contributed to performance. An overweight to the Mexican peso and Polish zloty detracted, but the impact was offset by an underweight to the Hungarian forint. An overweight to currencies of savings-rich economies, such as Canada, further boosted performance.

Outlook

Developments in Europe will continue to cast a shadow over the global macroeconomic environment as we enter 2012. Despite the near-term success of the European Central Bank's (ECB) liquidity injection in preventing a major bank funding crisis and containing a self-fulfilling panic in the short run, larger issues remain in addressing the long-term sovereign funding crisis. Borrowing costs in peripheral countries, particularly in Italy and Spain (about whose debt dynamics investors are most concerned) remain high and, absent strong growth, are vulnerable to further bouts of risk aversion. Italy and Spain alone need to roll over €150 billion of debt in the first quarter of 2012 in what will prove to be a major test of investors' confidence in the countries' debt sustainability.

While the ECB comfortably performed its lender-of-last-resort function for the banking system, it is reluctant to do so for sovereigns. This form of quantitative easing cannot be viewed as a direct substitute for fiscal rectitude. It will take time to approve International Monetary Fund (IMF) disbursements and to determine the exact mechanics of the European Stability Mechanism (ESM); this wait will create uncertainties in the interim and put pressure on peripheral sovereign debt. The ECB's Securities Markets Programme (SMP) has bought more than €200 billion of peripheral sovereign debt, an amount that we expect to rise if governments are given the time required to tackle their fiscal deficits. Although it is difficult to predict what breakthroughs, if any, can be agreed upon at the upcoming January EU summit, we have great conviction that the European countries face a long journey to fiscal solvency. What is obvious is that aggressive fiscal austerity will continue to take a toll on the European growth outlook. Italy has unveiled more deficit-reduction measures that point to a growth contraction of 0.5% in 2012. Spain's new spending cuts and tax increases to balance the 2011 budget shortfall still leave a €20 billion gap in its finances. Restoring confidence will require concrete decisions and clear communication, in the absence of which the "risk-on/risk-off" environment will persist.

Against the aforementioned uncertain backdrop for Europe, we expect to see two major themes that will dominate financial markets over the year: deleveraging and global growth divergence. Many countries and sectors have begun to unwind debt, but deleveraging by both consumers and governments is likely to be a key feature of many advanced economies. In contrast to Europe, the US economy is likely to fare moderately well in 2012 ahead of the November presidential election.

However, elections and other political uncertainties in the eurozone, Middle East and Russia—along with concerns about a slowdown in China and India—are key risks to the overall global economy. In China, growth remains robust but continues to slow on a year-over-year basis; however, we believe that monetary and fiscal policies will allow it to achieve a soft landing. The OECD projection has GDP growth moderating to 8.5% in 2012 from 9.3% in 2011. Monetary policies across the globe will continue to remain accommodative, while inflation threats (which hurt both emerging and advanced economies in 2011) will continue to abate. The recovery in global manufacturing data further supports our view of an overall moderate path to recovery. However, it's prudent to remain cautious at this juncture, as it will be a bumpy road ahead. We continue to navigate portfolios by employing dynamic hedging strategies to limit downside risk while focusing on long-term valuations.

Our underlying thesis remains unchanged as we enter 2012. We are running additional duration in core Europe through German bunds, focusing on the intermediate part of the curve. We expect the ECB to cut rates again in 1Q12, creating further downside pressure for the euro; hence, we maintain a meaningful underweight against the US dollar. We remain constructive on our emerging market currency programme, seeing it as a long-term secular theme that offers strong fundamentals. To balance the overall currency-risk allocation, we are overweight currencies of savings-rich economies.

We remain underweight the US agency mortgage-backed sector and overweight the investment-grade corporate sector, favouring globally diversified financial institutions that continue to build a robust capital base and that have ample liquidity. Against the emphasis on select financial issuers, we continue to run a neutral exposure to the industrial and utility subsectors.

We continue to run a modest bias to high-yield bonds, focusing on noncyclical 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.