

# 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

\$24,972,282.

## Performance (before fees and taxes)

	Trust %	Comparative Index%
3 months	1.24	2.37
1 year	24.59	18.35
3 years p.a.	8.52	9.56

Past performance is no indication of future performance.

## Profile

### Portfolio Characteristics

Effective duration (years)	4.5
Average credit quality (Standard & Poor's)	BBB+

### Sector Allocations

	%
Government	14.4
Investment grade	15.6
Mortgage and asset backed	2.6
High yield	26.6
Emerging markets	23.8
Inflation protected securities	0.8
Cash and other securities	16.2

## Market Review

Markets struggled to digest a barrage of announcements during the June quarter, the consequences of which had yet to be determined. The highly anticipated shift in China's exchange rate regime was finally announced, although it seemed a statement of intent rather than a roadmap for future policy. While details remained thin, it seems that China will reintroduce the crawling peg that existed from July 2005 until July 2008, at which time a parity of 6.83/USD was fixed. The Peoples Bank of China will allow a +/- 0.5% daily trading band around a central parity against the US dollar.

Movements may begin to reflect a broader basket of currencies, consistent with China's major trading partners. Appreciation expectations remained modest. Non-deliverable forward contracts implied yuan appreciation of around 3% over the next 12 months against the U.S. dollar, below expectations seen earlier in the year.

In the U.K., the Chancellor of the Exchequer announced that the pace of fiscal consolidation will be accelerated, bringing the structural budget back into surplus by 2015. This will be achieved in part with a rise in the consumption tax, which should put further upward pressure on inflation. A number of Bank of England members flagged this as concerning. Turning to the other side of the pond, the U.S. Congress defeated a jobs bill and both the G20 and the International Monetary Fund released statements arguing for the prioritisation of fiscal deficit reduction. The financial reform bill in the U.S. appeared close to being signed into law. Many of the provisions were intentionally left open to interpretation; this means that regulatory agencies will still have scope to adjust its impact.

Economic data suggested a slight moderation in the pace of economic expansion and inflationary pressures remained muted. Manufacturing indices declined around the globe and confidence surveys suggested that consumers were becoming more cautious. Home sales plunged in the U.S. as the first time homebuyer tax credit expired. Most major central banks held steady. The Bank of Canada was an exception, and surprised markets somewhat by raising its policy rate to 0.50%. A few Bank of England policy-makers raised concerns that U.K. inflation had not dampened in line with U.S. and European inflation.

Government bonds performed well as the bid for low risk assets increased. Corporate bonds saw spread contraction early in the quarter more than offset by sharp widening as the Eurozone crisis hit its peak in May. 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.

After a brief rally in early June, global equity markets fell following weak economic data from the U.S., continued concerns over the sovereign debt situation in peripheral Europe and strains within the European banking system.

## Performance

The Legg Mason Global Multi Sector Bond Trust underperformed its comparative index over the course of the quarter. However, portfolio performance over the past year was 6.2% ahead of the comparative index.

Over the quarter, currency allocations and security selection within the portfolio's credit holdings aided portfolio performance. However, the portfolio's underweight to duration detracted from performance.

The portfolio tactically increased duration late in the period as a hedge against the credit risk. In addition, we sold the portfolio's treasury inflation protected securities and Australian inflation linked bonds as real yields declined and in case markets moved to price in deflation. We added to select non-cyclical, non-financial investment grade corporate bonds and new issue high yield bonds. We expect to continue with this strategy in the coming months.

## Outlook

Those who predict a double-dip recession often invoke the U.S. experience in the early 1980s. We find this an invalid inference, as the Volcker Federal Reserve purposefully engineered the U.S.'s second recession in 1981. The funds rate doubled, reaching 20% for a second time just months after the first of the double-dip recessions ended. Overall, 24 months of economic contraction were required to break the cycle of inflationary expectations that had solidified during the preceding decade. In contrast, monetary authorities today are engaged in unprecedented reflationary policies in a focused effort to stimulate growth. We expect gross domestic product growth to slow toward equilibrium growth rates in the next six months as the inventory restocking cycle concludes and fiscal stimulus fades. A second recession would additionally require a second shock. While we do not believe this is likely, candidate shocks include a second banking panic and premature fiscal consolidation.

Considering these potential shocks, today's global financial system is flush with central bank liquidity, benefits from government guarantees on liabilities and has access to unlimited dollars via official currency swap lines. Solvency has been bolstered by more than US\$1.5 trillion of capital injections. Further de-leveraging is necessary, particularly in Europe, but future liquidity crises should be minor and short-lived. As for premature fiscal consolidation, the pendulum has recently swung in favour of those who advocate an accelerated pace of deficit reduction.

This is somewhat concerning for risk assets but so far monetary stimulus should be able to offset the scaling back of fiscal support. That said, monetary authorities will have to remain supportive for some time.

The portfolio is expected to be managed tactically as both market pricing and underlying fundamentals continue to display volatility. For example, with government yields down substantially over the past two months, we reduced the portfolio's duration position in the U.S.

We continue to maintain an overweight to the Financials sub-sector, with a clear emphasis on globally diversified banks that are large and benefit from multiple sources of funding. Small regional banks with concentrated assets and single business lines are expected to struggle. We will continue to avoid these issues. Our preference is to gradually shift up the capital structure into more senior issues as pricing and market conditions warrant. In addition, given the anticipated slow growth environment ahead of us and the recent underperformance of investment grade bonds, we will look to increase the allocation of non financial corporates as well. As has been the case for six months now, we look to also remain underweight agency mortgage-backed securities.