LEGG MASON
GLOBAL ASSET MANAGEMENT

Legg Mason Royce
US Small Cap Opportunity Fund

QUICK VIEW

Key performance drivers

- The Fund rose 3.69%[1] in June, underperforming its benchmark, which was up 5.32% over the month.
- Stock selection in the information technology (IT) sector weighed most on relative returns.
- Stock picking in industrials also hurt.
- Underweight exposure to healthcare, one of the best-performing sectors in June, detracted from relative returns.
- The Fund's cash position also proved detrimental.
- An underweight to consumer staples added value, as did the Fund's overweight to IT.

Views and positioning

- At the end of June, the Fund's most significant overweights were in the IT, industrials and materials sectors.
- Within IT, the manager favours semiconductors, based on expectations of a turnaround, but largely avoids internet and software stocks.
- Healthcare, financials and consumer staples remain the most significant underweights.
- Energy exposure also continues to be significant.
- The Fund continued to have no holdings in utilities companies.

Current activity and manager outlook

- The manager remains optimistic, continuing to see economic growth, which should especially benefit the turnaround stories in the Fund.
- In terms of activity, recent additions to the Fund include defence names, including companies that provide software surveillance and electronics for the defence industry.
- The manager remains positive about the consumer and the outlook for the economy, so exposure to retail and housing remains vital, as these areas should directly benefit from improving employment.

Performance[1] to 30/06/14	1 Month	3 Months	YTD	1 Year	5 Years
Legg Mason Royce US Small Cap Opportunity Fund	**3.69%**	**-0.28%**	**2.83%**	**23.16%**	**22.89%**
Russell 2000 Index	5.32%	2.05%	3.19%	23.64%	20.21%

Past performance is no guide to future returns and may not be repeated.

Market Review

US equities enjoyed another strong month, particularly small caps, which outperformed the S&P 500 in June. Markets rose amid encouraging data with the US economy having added 288,000 jobs in June, according to the Bureau of Labor Statistics, bringing the unemployment rate down to 6.1%, its lowest level since September 2008. These figures helped bolster investor confidence after the disappointing first-quarter growth figures released during the month. A third estimate from the US Commerce Department showed that the economy shrank at an annualised rate of 2.9% in the first three months of the year due to harsher-than-expected winter weather. Nonetheless, the economy is expected to have recorded a sharp recovery during the second quarter of the year. Against this backdrop, energy, healthcare and information technology (IT) were the leading sectors in the small-cap space, while the consumer staples sector was the month's laggard.

Fund Review

The Legg Mason US Royce US Small Cap Opportunity Fund increased 3.69%[1] in US dollar terms in June, underperforming its benchmark, the Russell 2000 Index, which rose 5.32% in dollar terms.

Stock selection in the information technology (IT) sector (notably semiconductor stocks) weighed most on relative returns in June, with Finisar, a manufacturer of optical communication components, down significantly over the month. Stock picking in industrials (aerospace and defence stocks) also hurt, notably Layne Christensen, Kratos Defense & Security and Air Lease. From a sector perspective, underweight exposure to healthcare, one of the best-performing sectors in June amid a rebound in biotechnology stocks, detracted. The Fund's cash position also proved detrimental. Conversely, an underweight to consumer staples, the worst-performing sector in June, and overweight to IT added value.

Over the second quarter, selection in the IT (particularly semiconductor equipment and hardware stocks), consumer discretionary and materials sectors hurt. Investments in financials, where the Fund has low exposure to real estate investment trusts (REITs), which did well in a context of declining long-term interest rates, although this conversely hurt the Fund's insurance stocks, also detracted. Investments in healthcare had a positive impact. Lack of exposure to robustly performing utilities hurt, while an overweight to energy was positive.

PLEASE REFER TO THE IMPORTANT INFORMATION ON THE FINAL PAGE.

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Fund Review (cont'd)

In terms of positioning, the most significant overweights are in the IT, industrials and materials sectors. Within IT, the manager favours semiconductors, based on expectations of a turnaround in this industry, but largely avoids internet and software stocks. Healthcare, financials and consumer staples remain the largest active underweight allocations. The underweight in healthcare is in large part explained by the absence of biotech stocks, which, in the manager's opinion, do not lend themselves well to the Fund's 'turnaround' strategy. The Fund continued to have no holdings in utilities companies. Although underweight in financials, the Fund's exposure to this sector remains close to all-time-high levels. This reflects opportunities in community banks, which the manager believes are likely to benefit from higher long-term interest rates, as well as financial guaranty and mortgage insurance firms, which should profit from an improving housing market.

Outlook

The manager remains optimistic, continuing to see economic growth, which should especially benefit the turnaround stories in the Fund. It expects to see good gross domestic product (GDP) growth, which should drive earnings and stock prices in turn. On the whole, the manager believes that things should improve when the second-quarter earnings reports start to be released over the next few weeks. That said, for the next couple of months at least, the manager anticipates a 'fight' between stock prices and rising rates. In its view, it is a simple equation: if rates are going up because the economy is stronger, then the small companies held in the Fund should do well, since they should be able to capitalise on higher margins or incremental business that results from that stronger growth. Over the long term, the manager believes that this should be positive for small-cap stocks. In addition, the merger & acquisition (M&A) cycle seems to be picking up, which is both a blessing and a curse for the Fund, as it tends to lose a fair number of companies to M&A. While it helps short-term performance, with an average 30% premium for the company, this compares to the 40-50% premium that the manager believes companies, in general, are worth over the longer term.

In terms of activity, recent additions to the Fund include defence names, such as companies that provide software surveillance and electronics for the defence industry. The manager remains positive about the consumer and the outlook for the economy, so exposure to retail and housing remains high, as these areas should directly benefit from improving employment. The manager has also reduced exposure to banks, especially those with agricultural exposure. Energy exposure also continues to be significant.

This Fund is managed by Royce & Associates

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[1] Source: Legg Mason, as of 30 June 2014. Class A Acc USD performance is net of fees and is calculated on a NAV to NAV basis (USD), with any income and dividends reinvested, if any, without any initial charges but reflecting annual management fees. Performance figures inclusive of sales charge is -1.49% for 1 Month, -5.27% for 3 Months, -2.31% for YTD, 17.00% for 1 Year and 21.64% for 5 Years. Performance for periods above one year is annualised. **Investment involves risks. Past performance is not indicative of future results.**

IMPORTANT INFORMATION

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