LEGG MASON
GLOBAL ASSET MANAGEMENT

Legg Mason Royce
US Small Cap Opportunity Fund

QUICK VIEW

Key performance drivers

- The Fund rose 1.08%[1] in US dollar terms in May but underperformed its benchmark, the Russell 2000 Index, which was up 2.28%.
- Stock selection contributed in industrials and financials but detracted in consumer discretionary and healthcare.
- Underweight exposure to healthcare was detrimental but an overweight to information technology (IT) was beneficial.

Views and positioning

- At the end of May, the Fund's most significant overweights were in the IT, industrials and materials sectors.
- Within IT, the manager favours semiconductors, on valuation grounds, but largely avoids internet and software stocks.
- Financials, healthcare and utilities are the most significant active underweights.

Current activity and manager outlook

- In the manager's opinion, there are a number of factors that could lead to better relative performance moving into the second half of the year.
- These are a reacceleration of the US economy, better consumer trends and return to favour of value investing, all of which would benefit the Fund.

Performance[+] to 31/05/15	1 Month	3 Months	YTD	1 Year	5 Years
Legg Mason Royce US Small Cap Opportunity Fund	**1.08%**	**0.41%**	**0.97%**	**-0.40%**	**12.41%**
Russell 2000 Index	2.28%	1.41%	3.98%	11.32%	15.04%

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

Market Review

US equities advanced during the month despite continued sluggishness in the domestic economy. A second reading on first-quarter gross domestic product (GDP) showed that the economy shrank by 0.7% during the first three months of the year, hurt mainly by a strong dollar, difficult winter conditions and the one-off effect of reduced investment in the energy sector. The GDP revision showed that inventories grew at a slower pace than initially forecast and consumer spending climbed less than expected. May's consumer sentiment reading from the University of Michigan plunged to its lowest level since October while factory production stalled in April. In the manager's opinion, such weakness has likely pushed back the date when the US Federal Reserve (Fed) will begin to raise interest rates to later in the year. Meanwhile, a continued rebound in oil prices, along with signs of better economic growth in Europe, appears to have quelled deflation fears and re-introduced inflation as a potential risk. This led investors to favour stocks during the month, to the detriment of fixed income especially European sovereign bonds with negative real yields. The yield on the 10-year US Treasury spiked 24 basis points in the first half of May and, at month end, remained near its highest level of the year. Small-cap stocks outperformed their large-cap counterparts in May. In terms of sectors, market leadership swung back over the month to healthcare and technology while energy stocks sold off.

Fund Review

The Legg Mason Royce US Small Cap Opportunity Fund increased 1.08%[1] in US dollar terms in May, underperforming its benchmark, the Russell 2000 Index, which rose 2.28%.

Selection in the consumer discretionary and healthcare sectors (notably no biotech stocks, which rebounded strongly over the month) had a negative impact over the month. Conversely, stock picking in industrials and financials (no Real Estate Investment Trust (REITs)) added value. At a sector level, underweight exposure to healthcare, the best-performing segment in May, proved detrimental, although this was countered to some degree by an overweight in information technology (IT), particularly semiconductor stocks, which outperformed over the month.

PLEASE REFER TO THE IMPORTANT INFORMATION ON THE FINAL PAGE.

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Fund Review (cont.)

At the end of May, the largest overweights are in IT, industrials and materials. In IT, the manager favours semiconductors, which it feels are attractively valued, but largely avoids internet and software stocks. Financials, healthcare and utilities are the largest active underweights. In healthcare, this is largely due to an absence of biotech stocks, which, in the manager's opinion, do not lend themselves well to the Fund's 'turnaround' strategy. Though underweight in financials overall, exposure to this sector remains close to all-time-high levels. This reflects select opportunities in community banks in certain US states, which the manager believes should benefit from higher long-term interest rates, as well as financial guaranty and mortgage insurance firms, which could profit from an improving housing market. The largest underweight in this space is to REITs, mainly on valuation grounds.

Outlook

This year has seen a continuation of the trends at play last year, i.e. a market driven by healthcare on one hand and "bond proxies" (REITs, utilities) on the other, which together represented 80% of the Russell 2000 4.9% return last year. Year to date, market leadership has been even narrower, with healthcare almost singlehandedly leading the way. The Fund's underweight exposure to this area of the market has been detrimental. Smaller stocks within the Russell 2000, which the manager favours, have been particularly under pressure so far this year. More broadly, the Fund's value style has been a headwind in a context where the Russell 2000 Growth index has significantly outperformed the Russell 2000 Value index. However, in the manager's opinion, there are a number of factors that could lead to better relative performance moving into the second half of the year. First of all, a reacceleration of the US economy after a weak first quarter dragged down by difficult weather conditions could benefit the Fund, which, given its turnaround nature, is very sensitive to GDP growth trends although, according to the manager, it does not require strong growth to do well. Secondly, the Fund could benefit from better consumer trends with households feeling more confident to spend rather than save the windfall that lower energy prices represent. A significant rebound in housing, of which the latest strong housing starts number could be an early sign, could also bolster future Fund performance. The Fund has a high allocation both to homebuilders and building products companies, which would likely be beneficiaries. Thirdly, the Fund could benefit from a period of mean reversion in favour of value versus growth given the magnitude of the outperformance of the latter over the former in recent years. Finally, the manager believes that the Fund's portfolio of cheap stocks, particularly in the technology space (representing approximately 30% of the Fund), has the potential for improvement in the coming months.

This Fund is managed by Royce & Associates

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[1] Source: Legg Mason, as of 31 May 2015. 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 -3.97% for 1 Month, -4.61% for 3 Months, -4.08% for YTD, -5.38% for 1 Year and 11.26% for 5 Years. Performance for periods above one year is annualised. **Investment involves risks. Past performance is not indicative of future results.**