LEGG MASON
GLOBAL ASSET MANAGEMENT

Legg Mason Royce
US Small Cap Opportunity Fund

QUICK VIEW

Key performance drivers

- The Fund fell 5.29%[1] in US dollar terms in October, underperforming its benchmark, the Russell 2000 Index, which was down 4.75%.
- Stock selection detracted in materials and consumer discretionary but contributed in information technology (IT).
- Underweight exposure to financials hindered relative returns but an underweight to healthcare helped.

Views and positioning

- At the end of October, the Fund's most significant overweights were in the IT, industrials and materials sectors.
- Financials, real estate and healthcare are the most significant active underweights.

Current activity and manager outlook

- The manager sees potential opportunities in infrastructure, defence, non-residential construction and consumer discretionary.

Performance[1] to 31.10.16	1 Month	3 Months	YTD	1 Year	5 Years
Legg Mason Royce US Small Cap Opportunity Fund	**-5.29%**	**-1.20%**	**10.77%**	**6.06%**	**9.63%**
Russell 2000 Index	-4.75%	-1.99%	6.16%	4.11%	11.51%

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

Market Review

Equity markets suffered broad losses in October with the S&P 500 Index falling 1.82%, its sharpest drop since January. Small caps were down even more, with the Russell 2000 Index returning -4.75%. Growth stocks underperformed value stocks for the month. Volatility also picked up, reaching its highest levels since Brexit, as anxiety over the upcoming US presidential election caused investors to retreat from risk. Stocks sold off as revenue growth proved elusive amid mostly mediocre third-quarter corporate results, with companies offering uninspiring guidance. October was a record month for merger & acquisition activity with AT&T making an US$84 billion offer for Time Warner, but announced deals failed to provide much support. Equities also took a cue from the fixed income market, which saw sharp losses as bond yields moved higher on the likelihood of higher interest rates and higher inflation, with the yield on the 10-year US Treasury increasing 23 basis points during the month. The US dollar rose against foreign currencies while crude oil prices fell 3%, hurting energy stocks.

Fund Review

The Legg Mason Royce US Small Cap Opportunity Fund decreased 5.29%[1] in US dollar terms in October, underperforming its benchmark, the Russell 2000 Index, which was down 4.75%.

Stock selection in consumer discretionary detracted over the month, particularly Tri Pointe Group. Stock-picking in materials also weighed on relative returns; Kraton, Allegheny Technologies and Carpenter Technology were all down in October. Conversely, a number of the Fund's holdings in information technology (IT) contributed, such as TTM Technologies, II-VI, Unisys, Ultra Clean and Mentor Graphics.

From a sector perspective, an underweight allocation to healthcare, which in contrast to September, when it led the field, was the worst-performing sector in October, added value. However, this impact was diluted by the negative bearing of the Fund's underweight to the outperforming financials sector.

At month-end, the largest overweights were 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, real estate and healthcare 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.

PLEASE REFER TO THE IMPORTANT INFORMATION ON THE FINAL PAGE.

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Outlook

There have been a number of merger & acquisition (M&A) takeovers in the Fund year-to-date and across a range of industries. The manager anticipates a few more deals to come in the last quarter of the year. The manager also expects infrastructure to receive a significant boost regardless of the winner of the upcoming US election. This could benefit the Fund, as four of the top ten names held are direct plays on infrastructure spending. The manager also believes that the US economy could surprise on the upside, supported by a stronger consumer, and rebounds in the oil price and US dollar. The manager also feels that corporate earnings have the scope to re-accelerate. The Fund has exposure to defence and so stands potentially to benefit from increased expenditure in this area, regardless of the administration. The manager also sees potential opportunities in broader non-residential construction space as well as the consumer discretionary sector. The US consumer continues to benefit from a number of supporting factors namely robust employment, low energy prices and a relatively strong dollar making imported goods affordable. The manager believes this bodes well for consumer spending overall.

This Fund is managed by Royce & Associates

[1] Source: Legg Mason, as of 31 October 2016. 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 -10.02% for 1 Month, -6.14% for 3 Months, 5.23% for YTD, 0.76% for 1 Year and 8.51% 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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