

## Global equity performance mixed, while bond markets shaken by news from Greece



### ALSO INSIDE

KEY THEMES

---

MARKETS AT A GLANCE

---

THE VIEW FROM LEGG MASON

---

### Market Review

Global equity markets delivered a mixed performance in February as US stocks provided gains, although many international stocks fared less well for the month. Despite an improving economic outlook for many regions of the world, international stocks delivered lacklustre returns in many markets given a US dollar rally against other currencies and concerns about sovereign debt in Europe and the stability of the euro. Investors were also concerned about China and actions to restrict lending by banks, ramping up fears that economic growth in emerging markets won't live up to expectations going forward.

February was a volatile month for the riskier sectors of global bond markets. Concerns over the state of public finances and the increased default risk on government debt, particularly in peripheral European countries such as Greece, weighed on the market in the first half of the month. However, supportive economic data, as well as comments from European Union officials that aid would ultimately be forthcoming for Greece, steadied markets and helped drive a partial recovery. European bond markets outperformed the US. Corporate bonds, both investment grade and high yield, generally underperformed government debt, with the financial subsector, especially subordinated issues, trailing the overall market.

## Markets at a Glance

	MONTH	YEAR-TO-DATE	1 YEAR
<b>MSCI WORLD INDEX</b>	<b>1.41%</b>	<b>-2.78%</b>	<b>54.30%</b>
<b>BARCLAYS CAPITAL GLOBAL AGGREGATE INDEX (BONDS)</b>	<b>0.07%</b>	<b>0.49%</b>	<b>13.62%</b>
<b>S&amp;P 500 INDEX</b>	<b>3.02%</b>	<b>-0.71%</b>	<b>52.60%</b>
<b>MSCI EUROPE EX-UK INDEX</b>	<b>-2.25%</b>	<b>-8.53%</b>	<b>57.01%</b>
<b>FTSE ALL SHARE INDEX</b>	<b>-1.79%</b>	<b>-6.03%</b>	<b>57.37%</b>
<b>MSCI ASIA EX-JAPAN INDEX</b>	<b>0.50%</b>	<b>-5.57%</b>	<b>83.86%</b>
<b>MSCI JAPAN INDEX</b>	<b>1.12%</b>	<b>3.04%</b>	<b>34.07%</b>
<b>MSCI EMERGING MARKETS INDEX</b>	<b>0.35%</b>	<b>-5.24%</b>	<b>91.63%</b>

All returns are in US dollar terms as at 28/02/2010. Source: Legg Mason.

### GLOBAL EQUITIES

#### GLOBAL CURRENTS

The manager observes that high unemployment, consumer deleveraging and a lack of lending remain headwinds for growth. It is also concerned about the differences between actual earnings and revenues versus expectations, which, it thinks, appear to be unrealistic. On the economic front, the manager believes the recovery appears to be reflecting a modest bounce in growth. However, it thinks that structural weaknesses remain that are unlikely to support a global economic boom. More work needs to be done, for instance, in addressing deficit reduction, excessive leverage and debt-fuelled consumption. In short, the manager believes the road to sustainable recovery will be paved by growth derived from income, productivity and investment – not debt and speculation. Looking ahead, the manager remains positive, yet cautious and prudent. It has therefore positioned its portfolios to demonstrate resilience in a marketplace that may throw up both headwinds and opportunities.

### GLOBAL FIXED INCOME

#### WESTERN ASSET MANAGEMENT

The manager believes that concerns over the state of public finances are likely to lead the market to differentiate more between government bonds of varying risk for some time. As a value investor with a longer term investment horizon, it thinks this short-term volatility presents it with an opportunity. Indeed, it aims to overweight exposure to Greece relative to the rest of peripheral

Europe in the expectation that the valuation differential between Greece on the one hand, and Spain and Italy on the other, will narrow. This theme also plays into its current currency strategy. The manager continues to favour a reduced exposure to the euro, preferring US and Canadian dollars, and a number of other European currencies with stronger fundamentals.

In stark contrast to government finances, the manager says that corporate balance sheets are continuing to improve. Although corporate bond valuations have improved significantly compared to one year ago, it continues to see value in the asset class. However, the manager is mindful of volatility along the way to further gradual improvement, with areas of concern including the effects of a reduction in global monetary policy support, elevated levels of risk on government bonds in a number of peripheral European countries and China's methods for slowing down its robust economy.

### US EQUITIES

#### LEGG MASON CAPITAL MANAGEMENT

The manager continues to be constructive on the outlook for US equities for the balance of this year. For a number of reasons, it believes the recent market correction may have run its course and that the market has resumed an upwards trajectory. In contrast to last year's advance, which was steep and fairly unrelenting, it sees potential gains this year as likely to be more modest, though still worthwhile, and upwards progress as likely to be a bit choppy.

## Key Themes

### GLOBAL EQUITIES

Positive outlook, but investors must tread carefully

### GLOBAL BONDS

Continued value in corporate bonds

### US EQUITIES

Gains likely to be more modest in 2010

### EUROPEAN EQUITIES

Increasingly driven by fundamental factors

### ASIA-PACIFIC EQUITIES

Upwards earnings revisions across the region

### JAPANESE EQUITIES

Chinese tightening casts shadow over Japanese export recovery

### EMERGING MARKETS EQUITIES

Economic backdrop supportive of corporate earnings

The manager sees the economic backdrop and the favourable outlook for corporate earnings as supportive of higher stock prices over the balance of the year. With a few notable exceptions, it thinks the economic data continues to be encouraging. The latest housing numbers were pretty weak, but it believes some of that weakness could be weather-related. The real test for housing, the manager observes, will be the spring selling season. If housing is still weak then, it thinks we may have a problem. Apart from housing, the manager also notes that the drop in consumer sentiment is a bit worrying, although perhaps understandable given the weakness in housing, the recent pullback in the equity market, and the dreary winter. In short, the manager thinks consumer confidence needs to revive in order to support an increase in consumer spending.

## EUROPEAN EQUITIES

BATTERYMARCH FINANCIAL MANAGEMENT

Regarding the outlook for Europe, the manager observes that the European Central Bank said that it expects there will be moderate economic expansion during 2010, while emphasising the need to reduce government deficits. The manager believes that because of the current fragility of the world's economies, what lies ahead for equity markets may in large part be determined by policymakers. Continued fiscal support for too long could lead to inflation, although withdrawing too quickly could upset whatever recovery has taken hold. The manager adds, however, that the decline in macro-driven events, lower overall market volatility and higher stock price dispersion bode well for a return to markets driven by fundamentals. The manager also notes that growth expectations have been improving and estimate revisions are generally positive.

## UK EQUITIES

BATTERYMARCH FINANCIAL MANAGEMENT

The manager notes that the performance of the UK equity market is significantly driven by global companies that have been rewarded in the rally since March. However, the manager notes that the UK economy lagged the other major developed countries in moving out of recession. Economic data towards the end of the year 2009 and the start of 2010 was

mixed. As markets look beyond the near-term concerns, analysts' earnings expectations are just beginning to be revised positively for 2010. Although the near-term economic outlook will take some time to improve, the investment manager believes that value can still be found in the UK equity market.

## ASIA-PACIFIC EQUITIES

BATTERYMARCH FINANCIAL MANAGEMENT

Looking ahead, the investment manager notes that earnings estimate revisions are rising in Asian markets and are positive across the region. It thinks that the backdrop of attractively valued currencies and strong foreign reserve positions in most Asian countries continues to provide a supportive environment for corporate earnings. Domestic consumption and infrastructure development also continue to benefit Asian markets, while exports to other emerging countries are also becoming a more significant driver of returns, thereby reducing dependence on the recession-weakened developed world.

## JAPANESE EQUITIES

CONGRUIX INVESTMENT MANAGEMENT

The manager observes that the Japanese market was broadly flat this month and so trailed most major global indices, which had staged a minor rebound off their recent lows. It says official data shows a pause in the strong inflow of foreign funds that we saw in January, consistent with the global trend of falling equity weightings in favour of fixed income and cash. The manager had battened down the hatches in January as the market looked over extended after the market had sprung back from its oversold situation in November. It thinks the market pull-back appears well advanced as we exit February. Equity and cash weightings globally have returned to September levels for a start, based on a Merrill Lynch survey. Japanese investors have also had sufficient time to digest the impact of major risk factors that have cropped up recently, including the Greek sovereign debt crisis, several disappointing macroeconomic data releases from the US plus the monetary tightening policy in China that together cast a pall over the Japanese export recovery currently underway. In addition, concludes the manager, there is currently some indecision over policy at the Bank of Japan.

"We battened down the hatches in January as the market looked over extended."

CONGRUIX INVESTMENT MANAGEMENT

## Markets at a Glance (continued)

### EMERGING MARKETS EQUITIES

BATTERYMARCH FINANCIAL MANAGEMENT

The investment manager continues to believe that the backdrop of attractively valued currencies, strong foreign reserve positions and increased domestic consumption in many emerging market countries provides a supportive environment for corporate earnings. Domestic consumption and infrastructure development also continue to benefit emerging markets. The manager adds that exports to other emerging countries are becoming a more significant driver of returns, thereby reducing dependence on the recession-weakened developed world.

### CHINA EQUITIES

LEGG MASON HONG KONG

Local markets rebounded in February, which was a short month made even shorter by the Chinese New Year. Business confidence in Hong Kong remained favourable: a high profile land auction received a favourable bid from an

experienced developer; retail sales continued to show strength; and there was robust new business creation, supporting confidence in employment and consumption. In other developments, the recent Hong Kong budget had a neutral impact, providing further stability, which is necessary for companies to plan for the future.

The manager notes that as investors observed stability returning to the economy, policy makers started to withdraw their stimulus support with sensitivity. While the remarkable economic rebound and resilience in China owed its success to well-timed fiscal and monetary stimulus in 2009, it adds, mainland China's tightening policy responses to the inherent negative impacts on areas such as inflation, integrity of the financial systems and property asset prices are being rolled out sequentially. The manager adds that valuations will need to digest these subtle shifts as economies exit from low-cost monetary conditions and companies learn to work with a contraction in credit.

"The road to sustainable recovery will be paved by growth derived from income, productivity and investment."

GLOBAL CURRENTS

This document does not constitute an invitation to invest. The value of investments and the income from them can go down as well as up and investors may not get back the amounts originally invested. The value of investments and the income from them can be affected by changes in interest rates, in exchange rates, general market conditions, political, social and economic developments and other variable factors. Past performance is no guide to future returns and may not be repeated.

This information has been prepared from sources believed reliable but is not guaranteed by Legg Mason Canada Inc. and is not a complete summary or statement of all available data. Individual securities mentioned are intended as examples of portfolio holdings and are not intended as buy or sell recommendations. Opinions expressed are subject to change without notice and do not take into account the particular investment objectives, financial situation or needs of individual investors. Forward-looking statements are based on current expectations and projections about future events and are inherently subject to, among other things, risks, uncertainties and assumptions about economic factors. Forward-looking statements are not guarantees of future performance and actual events and results could differ materially from the opinions and expectations expressed.

Issued and approved by Legg Mason Canada Inc. Legg Mason Canada is part of the Legg Mason group of companies. Legg Mason Canada makes available to Canadian institutional investors, market commentary and economic updates from Legg Mason's affiliated investment managers ("Affiliated Managers"). Each of the Affiliated Managers referred to herein is affiliated with Legg Mason Canada through common control and ownership by Legg Mason, Inc, a global asset management firm headquartered in Baltimore, Maryland. Except as specifically permitted and subject to applicable restrictions and regulations, the products or services of the Affiliated Managers are not offered outside their intended countries or regions. The Affiliated Managers may not be registered in and may not be permitted to provide investment advice in all or any Canadian jurisdiction. In such cases, Canadian resident investors may only be able to gain access to them through Legg Mason Canada. Prospective investors are directed to visit our website at [www.leggmasoncanada.com](http://www.leggmasoncanada.com) for more information on Legg Mason Canada and its Affiliated Managers.

April 2010