LEGG MASON
GLOBAL ASSET MANAGEMENT

Legg Mason Western Asset Short Duration Municipal Income Fund

Team-managed

Market overview

While the recession hasn't officially been declared over, economic data released during the fourth quarter indicated that the lengthiest recession since the Great Depression has likely concluded. Looking back, the Commerce Department reported that U.S. gross domestic product ("GDP")[1] growth was -6.4% during the first quarter of 2009. The economy then contracted a more modest 0.7% during the second quarter. After declining for four consecutive quarters, GDP in the third quarter was a positive 2.2%, according to the Commerce Department.[2] A variety of factors helped the economy to expand, including the government's $787 billion stimulus program and its "Cash for Clunkers" car rebate program, which helped spur an increase in car sales. While the Commerce Department's initial estimate for fourth-quarter GDP won't be released until late January 2010, it's possible that economic growth accelerated during that period.

In terms of Federal Reserve Board ("Fed")[3] monetary policy, it continued to hold short-term interest rates at an historic low of 0 to 0.25% during the fourth quarter. The Fed has now kept short-term rates steady for more than a year. In conjunction with its December 2009 meeting, the Fed said that it "will maintain the target range for the federal funds rate at 0 to 0.25% and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period."

[1] Gross domestic product ("GDP") is the market value of all final goods and services produced within a country in a given period of time.
[2] Source: Bloomberg, 12/09.
[3] The Federal Reserve Board ("Fed") is responsible for the formulation of policies designed to promote economic growth, full employment, stable prices, and a sustainable pattern of international trade and payments.

Average annual total returns and fund expenses- Class A
(%) as of December 31, 2009

	1-yr	3-yr	5-yr	10-yr	Since incept. (3/17/03)	Gross*	Net**
Excluding sales charges	5.97	4.31	3.51	N/A	2.83	1.09	0.75
Including effects of maximum sales charges	3.66	3.54	3.05	N/A	2.47		
Barclays Capital Three-Year Municipal Bond Index	5.78	5.44	4.03	N/A	N/A		

Performance shown represents past performance and is no guarantee of future results. Current performance may be higher or lower than the performance shown. Investment return and principal value will fluctuate, so shares, when redeemed, may be worth more or less than the original cost. Class A shares have a maximum front-end sales charge of 2.25%. Total returns assume the reinvestment of all distributions at net asset value and the deduction of all Fund expenses. Performance data does not reflect trade date adjustments made to the NAV at month-end. Performance would have been lower if fees had not been waived in various periods. For the most recent month-end information, please visit www.leggmason.com/individualinvestors.

**Gross expenses are the Fund's total annual operating expenses for the share class indicated as of the date of the Fund's most current prospectus and do not reflect fee waivers or reimbursements. These expenses include management fees, 12b-1 distribution and service fees, and other expenses.*
***Net expenses are the Fund's total annual operating expenses for the share classes indicated as of the date of the Fund's most current prospectus and would reflect voluntary fee waivers and/or reimbursements, where these reductions would reduce the Fund's gross expenses. These waivers and/or reimbursements may be reduced or terminated at any time.*

The Barclays Capital Three-Year Municipal Bond Index is a broad measure of the municipal bond market of bonds with maturities of approximately three years. Please note that an investor cannot invest directly in an index.

As one would expect given overall positive news regarding the economy, both short- and long-term U.S. Treasury yields rose over the quarter, with the yield on the 2-year Treasury moving from 0.95% to 1.13% and the yield on the 10-year Treasury rising from 3.31% to 3.83%.[4] The yield curve steepened during the period, as long-term rates moved higher than their short-term counterparts given expectations for higher inflation down the road. Continuing the trend that began earlier in the year, the taxable spread sectors (non-U.S. Treasuries) outperformed equal-duration Treasuries during the fourth quarter. Over the three-month period, lower-quality securities generated solid results, as investor risk appetites remained strong as they searched for higher yields given the relatively low interest rate environment.

After posting exceptional returns over the first nine months of the year, the municipal bond market took a small step backward during the fourth quarter. The tax-free market sold off in October, as a large new issuance calendar was met with moderating investor demand. While municipal bonds prices rose in November and December, it was not enough to overcome their earlier weakness. During the quarter, shorter-term municipal bonds outperformed longer-term securities and higher-quality issues generated relatively better results than their lower-quality counterparts. As was the case with Treasuries, the municipal yield curve steepened during the last three months of the year. During that time, the yield on 1-year AAA municipal securities moved from 0.37% to 0.28% and the 30-year segment rose from 3.87% to 4.15%.[5]

Fund highlights

The Fund's positioning strategies produced mixed results during the fourth quarter. The Legg Mason Western Asset Short Duration Municipal Income Fund (A shares, excluding sales charges) returned 0.43% versus 0.80% for the Barclays Capital Three-Year Municipal Bond Index. Positively contributing to performance was the Fund's quality bias, as higher-rated municipal bonds outperformed their lower-rated counterparts. Also positively impacting the Fund was its shorter duration than the benchmark, as municipal rates rose during the quarter. Elsewhere, an overweight versus the benchmark in the hospital sector enhanced the Fund's results, as did its cash position. In contrast, the Fund's industrial development revenue/pollution control revenue and transportation bonds detracted from performance during the quarter.

Positively contributing to performance was the Fund's overweight exposures to the healthcare, industrial development revenue/pollution control revenue, power, education and special tax sectors. An underweight to state and local general obligation bonds was also beneficial. In contrast, the Fund's bias toward higher quality was not rewarded, as lower-quality municipal bonds generated superior results.

Outlook

Looking ahead, while the recession may be over, we don't expect to see a resumption of robust growth in 2010. Consumer spending, which makes up approximately two-thirds of GDP, could continue to be strained given the headwinds associated with the weak job market and slowly recovering housing prices. Given this, we expect inflation to remain benign and the Fed to be sensitive to the impact associated with raising short-term interest rates. We have a somewhat cautious near-term outlook for the municipal market, as state and local governments continue to experience budgetary challenges. However, we have a positive view on the long-term prospects for the municipal bond market. Demand for tax-exempt bonds should remain solid given the demographic trends in the U.S. and the likelihood that state and federal tax rates will move higher.

[4] Source: Bloomberg, 1/10.

[5] Source: Bloomberg, based on the performance of the Barclays Capital Municipal Bond Index and the Barclays Capital U.S. Aggregate Bond Index for the three-month period ended December 31, 2009.

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Top 10 holdings	(%)
Utah State 7/1/13 4.0000%	3.2
New York St Twy Auth Svc Contr 4/1/15 5.0000%	3.1
Gulf Coast Waste Disposal Auth TX 1/1/36 2.3000%	2.1
District Columbia Inc Tax R 12/1/12 5.0000%	2.0
York Cnty SC Pollutn Ctl Rev 9/15/24 4.0000%	1.9
Triborough Brdg & Tunl Auth N 11/15/27 5.0000%	1.8
California Statewide Cmntys 4/1/13 5.0000%	1.8
California Statewide Cmntys 6/15/13 5.0000%	1.8
Virginia St Pub Sch Auth 8/1/14 5.0000%	1.4
Orange County Fla Tourist Dev Ta 10/1/15 5.0000%	1.4
Top five sectors	
Health care	11.5
Transportation	11.0
Education	7.6
Industrial revenue	7.5
Special tax obligation	6.9

Percentages are based on total portfolio as of quarter-end, are subject to change at any time, and do not include trade date activity. For informational purposes only and not to be considered a recommendation to purchase or sell any security.

What should I know before investing?

Fixed-income securities involve interest rate, credit, inflation and reinvestment risks; and possible loss of principal. As interest rates rise, the value of fixed-income securities falls. High-yield bonds possess greater price volatility, illiquidity and possibility of default. Derivatives, such as options and futures, can be illiquid, may disproportionately increase losses, and have a potentially large impact on Fund performance. An investor may be subject to the federal Alternative Minimum Tax, and state and local taxes may apply. Capital gains, if any, are fully taxable.

The views expressed are those of the portfolio managers as of the date indicated, are subject to change, and may differ from the views of other portfolio managers or the firm as a whole. These opinions are not intended to be a forecast of future events, a guarantee of future results, or investment advice. All data referenced are from sources deemed to be reliable but cannot be guaranteed. Securities and sectors referenced should not be construed as a solicitation or recommendation or be used as the sole basis for any investment decision.

Portfolio holdings and sector allocations may not be representative of the portfolio manager's current or future investment and are subject to change at any time.

Prior to October 5, 2009, the Fund was known as Legg Mason Partners Short Duration Municipal Income Fund. The Fund's investment objective, portfolio managers and investment strategy have not changed. Please see the prospectus for details.

Before investing, carefully consider a fund's investment objectives, risks, charges and expenses. You can find this and other information in each prospectus, which is available at www.leggmason.com/individualinvestors. Please read it carefully.