

Legg Mason US Diversified Core ETF (Ticker: UDBI)  
Legg Mason Developed Ex-US Diversified Core ETF (Ticker: DDBI)  
Legg Mason Emerging Markets Diversified Core ETF (Ticker: EDBI)

# DIVERSIFICATION BY DESIGN



QS Investors' Diversification Based Investing (DBI, QS DBI™) takes a macro approach to building portfolios and balancing risk to deliver broad market exposure that can complement core portfolios. DBI is built on the understanding that:

- Capitalization-weighted indices may not be balanced across opportunities and risk in the market
- Different countries and sectors perform at different times, and predicting the next top performer is challenging
- Diversification across regions and sectors can improve risk/return characteristics

Based on a methodology developed over a decade ago for institutional investors, DBI is now available to individual investors through a family of exchange-traded funds (ETFs) focused on U.S., developed international, and emerging markets equities.

Diversification does not assure a profit or protect against a loss.

Equity securities are subject to price fluctuation and possible loss of principal.

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INVESTMENT PRODUCTS: NOT FDIC INSURED • NO BANK GUARANTEE • MAY LOSE VALUE

# THE UNINTENDED CONSEQUENCES OF CAP WEIGHTING

## Your core holdings may not be truly diversified

Investors are aware of the benefits of investing across asset classes, but often fail to diversify within them.

Investors often combine stocks, bonds and other alternatives, knowing that no one asset class will always outperform. While this concept is widely understood and employed, investors often neglect to diversify within each type of asset, leaving many investors under-diversified — and overexposed to certain parts of the market.

Investment products that reflect the market capitalization of stocks may lead to significant concentration in sectors or geographies, especially during market “bubbles.” Price movements in the largest holdings can have a meaningful effect on the overall portfolio’s performance and risk. Holding a large number of stocks will not necessarily improve the diversification of a portfolio if they are concentrated in a few sectors or countries. And if several sectors and geographies move in the same direction, this correlation may compound the impact.

Most “smart beta” strategies replace market weighting but gain other forms of bias.

**Equal-weighted** strategies can provide more diversification than market-capitalization strategies. However, they contain static biases to certain parts of the market.

**Factor-driven** strategies aggregate investments for certain desired characteristics (e.g., momentum) but by design, exclude certain segments of the market that can potentially drive return.

### Predicting the next top-performing region or sector is challenging, therefore diversification is a critical factor

 Utilities within the S&P 500 was the best-performing sector in two non-consecutive years and among the worst in the other three.

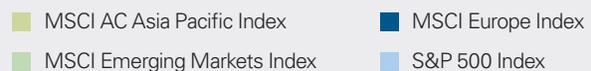
 European stocks outperformed other regions in one out of the past five years, but were the worst-performing in two other years.

#### S&P 500 sector returns (%)



	2015	2014	2013	2012	2011
Top performers	10	<b>29</b>	43	29	<b>20</b>
	7	25	41	24	14
Bottom performers	-8	3	<b>13</b>	5	-10
	-21	-8	11	<b>1</b>	-17

#### Regional index returns (%)



	2015	2014	2013	2012	2011
Top performers	1	14	32	<b>19</b>	2
	-1	0	<b>25</b>	19	<b>-11</b>
Bottom performers	<b>-3</b>	-2	12	17	-15
	-15	<b>-6</b>	-2	16	-18

Source: Bloomberg.

Please see back cover for index definitions.

Past performance is not a guarantee of future results. Diversification does not assure a profit or protect against a loss.

# MANAGING CONCENTRATION RISK

Focused on top-down geography and sector allocation instead of stock selection, QS DBI™ seeks to provide true diversification

Our research has shown that sector and country allocations in an equity portfolio are the main drivers of portfolio performance. Those who want to invest across equity markets may want to focus on diversification and limit exposure to countries and sectors that behave similarly.

This type of macro diversification can result in a more reliable core investment that fully participates in equity growth while mitigating unintended bets and therefore lowering drawdowns. This unique approach is designed to exhibit low correlation of excess return to active stock selection managers and market cap-weighted indexes.

The process is a repeatable, rules-based methodology designed to construct a truly diversified portfolio that adapts to changing market conditions over time.

## History of QS Diversification Based Investing

While the Legg Mason ETFs featuring the QS DBI methodology are new, the underlying investment discipline is not.



2001

### Launch DBI platform

A large U.S.-based pension fund challenged QS Investors to deliver a core holding with a risk/reward profile that would stand out from both market cap-weighted products and active strategies. The QS team tackled the challenge, developing this strategy into a disciplined, repeatable process relying on the measurement and minimization of correlations.

2002–2015

### Expand platform and client base

QS Investors delivers customized QS DBI-based solutions to several institutional clients.

2016

### Expand access to retail investors

This innovative QS DBI strategy is being delivered with all the features of the ETF structure, seeking to meet the needs of individual investors.

# A SYSTEMATIC, ADAPTIVE INVESTMENT PROCESS

1

## Identify market clusters<sup>1</sup>

- Divide investing universe into elements that can drive portfolio return: geography and sector. A company's location and the type of business it conducts have a meaningful impact on return.
- Analyze five-year return patterns of geographic/sector universe to uncover relationships: which markets and industries behave alike and which differently. These are identified in the chart at right by different colors.
- Group sets of highly correlated geographies/sectors into market clusters that are driven by economic forces and market behavior.

2

## Diversify across market clusters

- All market clusters are equally weighted across the portfolio, seeking to provide diversification.
- Within each of these market clusters, the geography/sector universe is also equally weighted.

3

## Adapt to changing environment

- Disciplined, repeatable process takes place annually to identify significant market trends and reflect changing conditions.
- The index is rebalanced quarterly to maintain target weights.

### QS DBI™

#### Seeks improved diversification

- Potential to deliver balanced macro exposure and complement cap-weighted products

#### Enhanced return potential

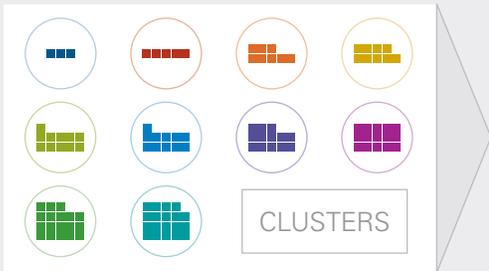
- Seeks to mitigate concentration risk and improve risk/return profile

<sup>1</sup> Note that the U.S. strategy clusters are identified at the sector and industry level.

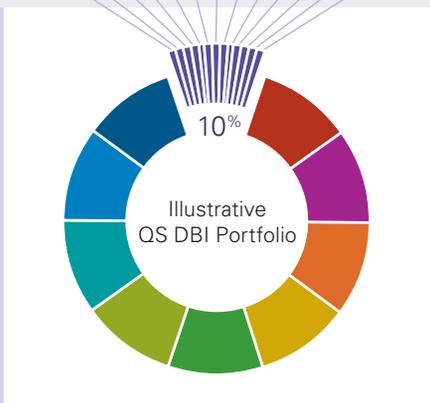
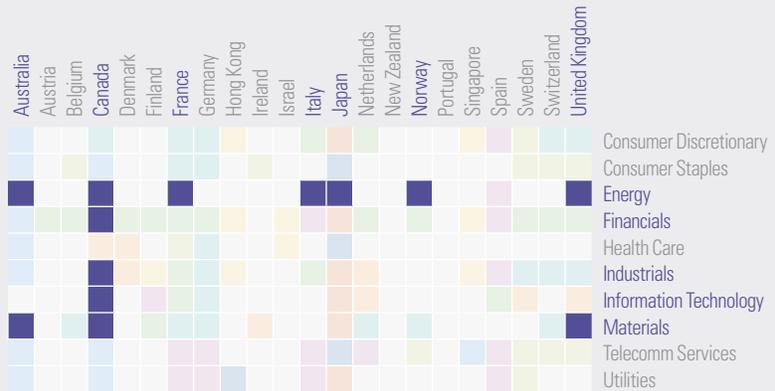
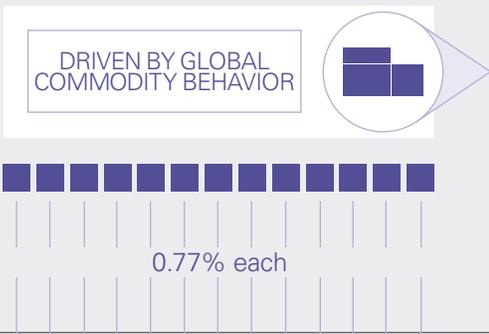
Diversification does not assure a profit or protect against a loss.



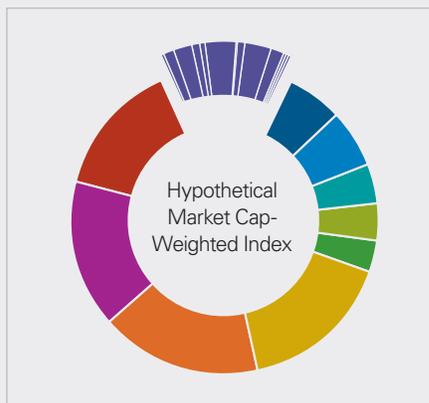
Individual colors signify sectors/  
geographies that have behaved alike.



**Market clusters = highly correlated groupings**



COMPARED TO



**Market cap-weighted Indexes**

**Concentration risk**

- Lack of balance across opportunities and risk in the market

# TRUE DIVERSIFICATION IS OFFERED IN THREE LEGG MASON ETFs

This quality strategy is now widely available to investors.

Legg Mason delivers three QS DBI™ exchange-traded funds covering domestic and international markets, providing worldwide equity exposure.

These funds can be easily layered onto existing holdings to potentially mitigate concentration risk or used as a basis for a core satellite portfolio.

## Potential benefits

True diversification can offer benefits to investors in two ways:

- 1 Seeks long-term returns better than those of the broader market benchmark.
- 2 Seeks less downside risk.

**A strong upside/downside capture ratio<sup>3</sup> provides proof of both.**

	Legg Mason US Diversified Core ETF	Legg Mason Developed Ex-US Diversified Core ETF	Legg Mason Emerging Markets Diversified Core ETF
Tickers	UDBI	DDBI	EDBI
<b>Investment objective</b>	Seeks to track the investment results of an index composed of publicly traded U.S. equity securities	Seeks to track the investment results of an index composed of publicly traded securities of developed markets outside the United States	Seeks to track the investment results of an index composed of publicly traded equity securities in emerging markets
<b>Goal</b>	To provide more balanced macro exposure to the U.S. equity market	To provide more balanced macro exposure to international markets	To provide more balanced macro exposure to emerging markets
<b>Stock universe</b>	Broad universe of 2,000+ U.S. stocks	Developed market stocks including European countries, U.K., Hong Kong, Japan, Australia, New Zealand and Canada	Stocks in developing economies including the BRICS, Indonesia, Malaysia, Mexico, Philippines, Turkey and others
<b>Diversification</b>	Across industry sectors	Across countries and industry sectors	Across countries and industry sectors
<b>Broad market benchmark</b>	Russell 3000 Index	MSCI World Ex-U.S. (Net) Index	MSCI Emerging Markets (Net) Index
<b>Underlying index<sup>2</sup></b>	QS DBI US Diversified Index	QS DBI Developed ex-US Diversified Index	QS DBI Emerging Markets Diversified Index

<sup>2</sup> Indices the ETFs seek to track. There is no guarantee that the Funds will achieve a high degree of correlation to the indices they seek to track. Fund Benchmark Index Methodology: The **QS DBI US Diversified Index** (the "Index") seeks to provide exposure to equities of U.S. companies and is based on a proprietary methodology created and sponsored by QS Investors, LLC ("QS"). The Index is composed of U.S. companies that are included in the MSCI USA IMI Index. The proprietary rules-based process initially groups this universe of securities into multiple investment categories based on industries. Within each of these investment categories, securities are weighted by market capitalization. The **QS DBI Developed ex-US Diversified Index** (the "Index") seeks to provide exposure to equity markets in developed countries outside the United States and is based on a proprietary methodology created and sponsored by QS. The Index is composed of equity securities in developed markets outside the United States that are included in the MSCI World ex-U.S. Index. The **QS DBI Emerging Markets Diversified Index** (the "Index") seeks to provide exposure to equity securities in emerging markets and is based on a proprietary methodology created and sponsored by QS. The Index is composed of equity securities in emerging markets that are included in the MSCI Emerging Markets Index. Please see back cover for important definitions.

<sup>3</sup> The **upside/downside capture ratio** illustrates a fund's ability to outperform — to gain more or lose less than — a broad market benchmark during periods of market strength and weakness. An upside capture ratio over 100 indicates a fund has generally outperformed the benchmark during periods of positive benchmark returns. A downside capture ratio of less than 100 indicates that a fund has lost less than the benchmark in periods when the benchmark has declined.

# QS DBI™ AND ETFs

## A STRONG COMBINATION

Legg Mason offers ETFs as part of its continuing commitment to meet client needs. QS DBI is a rules-based strategy built on a disciplined quantitative methodology, making it well-suited for delivery in the ETF vehicle.

### ETFs have characteristics that may offer benefits to investors:



#### Liquidity

Because ETFs trade in the secondary market, they can be bought or sold any time during market hours at real-time prices.



#### Fee considerations

ETF operations are streamlined, lowering structural costs and expenses.



#### Transparency

Portfolio composition is disclosed daily.



#### Potential tax advantages

ETFs may offer advantages for tax efficiency in comparison to traditional funds.<sup>4</sup>



### Who we are

QS Investors is known for its U.S. equity, global, international and emerging markets investment expertise and multi-asset portfolio management capabilities. Systematic risk management is embedded in all of QS Investors' investment processes. The Firm offers active equity and multi-asset solutions based on a range of macro, behavioral and bottom-up insights.

### Our mission

QS Investors' investment methodologies focus on risk identification, assessment and management aimed at delivering consistent and repeatable risk-managed returns.

### What sets us apart

QS Investors has developed proprietary methods to integrate fundamental, statistical, behavioral and technical insights using quantitative frameworks that can be used to position portfolios in multiple market environments.

### History

**Founding** — Formed in 1999 as part of the quantitative platform of a large global asset manager; developed proprietary DBI strategy.

**Evolution** — Became an independent investment advisor in 2010.

**Acquisition** — In 2014, became a wholly-owned, independently managed affiliate of Legg Mason, Inc.

**Today** — \$23.6 billion<sup>5</sup> under management; senior team averages more than 20 years of industry experience.

<sup>4</sup> Selling your ETF shares at a gain will trigger a taxable event. The differences between ETFs and mutual funds could significantly impact performance. These differences include but are not limited to investment strategy, tax implications, fees and expenses, cash flows, trading structures, and transparency requirements.

<sup>5</sup> As of June 30, 2016.

Brandywine Global  
Clarion Partners  
ClearBridge Investments  
EnTrustPermal  
Martin Currie  
QS Investors  
RARE Infrastructure  
Royce & Associates  
Western Asset

Legg Mason is a leading global investment company committed to helping clients reach their financial goals through long-term investment strategies.

- Over \$710 billion\* in assets invested worldwide in a broad mix of equities, fixed income, alternatives and cash strategies
- A diverse family of specialized investment managers, each with its own independent approach to research and analysis
- Over a century of experience in identifying opportunities and delivering astute investment solutions to clients

 [LeggMason.com](http://LeggMason.com)

## Additional resources

You'll find the most current information on our family of ETF products at [www.LeggMason.com](http://www.LeggMason.com).

**MSCI AC Asia Pacific Index** is a market capitalization-weighted index that is designed to measure the equity market performance of the developed and emerging markets in the Pacific region. **MSCI Emerging Markets Index** is a free float-adjusted market-capitalization index that is designed to measure equity market performance in the global emerging markets. **MSCI Europe Index** is an unmanaged index of Western European equity securities. **S&P 500 Index** is an unmanaged index of common stock performance. **WORLD EX-U.S.: MSCI All Country World Index ex-U.S. (ACWI)** is a market capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets, excluding the United States. **Russell 3000 Index** is an unmanaged index of 3,000 U.S. companies. **Smart beta** strategies are intended to move in near-perfect alignment with a market benchmark. These strategies use an alternative index construction rule that is rules-based and different from traditional market capitalization-based indices. **Factor-based** investment strategies use a strategy of following a specified market or index but are deliberately biased in one or more respects (e.g., company size, value, momentum). **BRICS** is a grouping acronym that refers to the countries of Brazil, Russia, India, China and South Africa, which are all deemed to be at a similar stage of newly advanced economic development.

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## What should I know before investing?

The Funds are newly organized, with a limited history of operations. Equity securities are subject to price fluctuation and possible loss of principal. In rising markets, the value of large-cap stocks may not rise as much as that of smaller-cap stocks. Small- and mid-cap stocks involve greater risks and volatility than large-cap stocks. The Funds may focus their investments in certain industries, increasing their vulnerability to market volatility. There is no guarantee that each Fund will achieve a high degree of correlation to the index it seeks to track. Each Fund does not seek to outperform the index it tracks, and does not seek temporary defensive positions when markets decline or appear overvalued.

Derivatives, such as options and futures, can be illiquid, may disproportionately increase losses, and have a potentially large impact on each Fund's performance. For **Legg Mason Developed Ex-US Diversified Core** ETF, international investments are subject to special risks, including currency fluctuations and social, economic and political uncertainties, which could increase volatility. For **Legg Mason Diversified Core Emerging Markets** ETF, international investments are subject to special risks, including currency fluctuations and social, economic and political uncertainties, which could increase volatility. These risks are magnified in emerging markets.

Diversification does not guarantee a profit or protect against a loss.

Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

Authorized participants ("APs") may acquire shares in the primary market directly from the ETFs and may tender their shares for redemption directly to the ETFs, at net asset value per share only in Creation Units or Creation Unit Aggregations. Once created, shares of the Funds generally trade in the secondary market in amounts less than that of a Creation Unit.

Retail investors buy and sell shares of ETFs at market price (not NAV) in the secondary market throughout the trading day. These shares are not individually available for purchase or redemption directly from the ETF. Market price returns shown are based upon the National Best Bid and Offer (NBBO) at 4:00 p.m. Eastern time. These returns will not represent your returns had you traded shares at other times.

\* As of December 31, 2016.

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If you are neither a resident nor a citizen of the United States or if you are a non-U.S. entity, a fund's ordinary income dividends (which include distributions of net short-term capital gains) will generally be subject to a 30% U.S. federal withholding tax, unless a lower treaty rate applies. For further information, please see each fund's prospectus which is available on the website [www.LeggMason.com](http://www.LeggMason.com). Redemption payments will be effected within the specified number of calendar days following the date on which a request for redemption in proper form is made. The funds generally intend to effect deliveries of creation units and portfolio securities on a basis of trade date "T" plus three business days ("T+3"). Please see each fund's statement of additional information for more information.

BEFORE INVESTING, CAREFULLY CONSIDER A FUND'S INVESTMENT OBJECTIVES, RISKS, CHARGES AND EXPENSES. YOU CAN FIND THIS AND OTHER INFORMATION IN EACH PROSPECTUS, AND SUMMARY PROSPECTUS, IF AVAILABLE, AT [WWW.LEGGMASON.COM](http://WWW.LEGGMASON.COM). PLEASE READ THE PROSPECTUS CAREFULLY.