ClearBridge Investments
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1Q 2019 | Product Commentary

CLEARBRIDGE INTERNATIONAL SMALL CAP FUND

Paul D. Ehrlichman, Sean M. Bogda, CFA, Safa R. Muhtaseb, CFA, and Grace Su
Portfolio Managers

Average annual total returns and fund expenses (%)

as of March 31, 2019

Class A	3-mo	1-yr	5-yr	10-yr	Since Incept. (10/01/10)	Expenses Gross	Expenses Net
Excluding sales charges	6.91	-15.62	0.21	N/A	6.11	1.50	1.42
Including effects of maximum sales charges	0.72	-20.45	-0.97	N/A	5.38	1.50	1.42
MSCI EAFE Small Cap Index	10.65	-9.36	4.47	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 5.75%. Total returns assume the reinvestment of all distributions at net asset value and the deduction of all Fund expenses. Total return figures are based on the NAV per share applied to shareholder subscriptions and redemptions, which may differ from the NAV per share disclosed in Fund shareholder reports. Performance would have been lower if fees had not been waived in various periods. Returns for less than one year are cumulative. For the most recent month-end information, please visit www.leggmason.com.*

Gross expenses are the Fund's total annual operating expenses for the share class(es) shown.

Net expenses are the Fund's total annual operating expenses for the share classes indicated and would reflect contractual fee waivers and/or reimbursements, where these reductions reduce the Fund's gross expenses, which cannot be terminated prior to December 31, 2020 without Board consent. In periods of market volatility, assets may decline significantly, causing total annual Fund operating expenses to become higher than the numbers shown in the table above.

The Gross and Net Expenses listed include 0.02 of Acquired Fund Fees and Expenses (AFFE) that are required to be shown in the Fund's prospectus. AFFE reflects the Fund's pro rata share of fees and expenses relating to its investments in acquired funds; however, AFFE are not incurred directly by the Fund. Therefore, AFFE are not reflected in the Fund's audited financial statements or financial highlights.

The **MSCI EAFE Small Cap Index** is an unmanaged, free float-adjusted, market-weighted index of small-capitalization companies in each industry group of each country represented by the MSCI EAFE Index, which is designed to measure the equity market performance of developed markets outside of the U.S. and Canada. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

Key takeaways

- The portfolio failed to fully participate in a momentum-driven rebound in international small-caps due to our underweight to technology stocks.
- Despite a muted recovery in emerging markets, including short-term headwinds in Brazil, we remain bullish on the outlook for the region.
- The main areas of contrarian opportunity continue to include the United Kingdom and cyclical value stocks hampered by fears of a global slowdown.

Market overview

After the dramatic fourth-quarter sell-off, global markets rebounded strongly in the first quarter of 2019. Adding to the January effect, U.S. Federal Reserve Chairman Jerome Powell's dovish turn reignited confidence in risk assets, driving global stocks to their best start in nearly a decade. Against this backdrop, the International Small Cap Fund's performance was mixed, compared with the 10.65% gain for the benchmark MSCI EAFE Small Cap Index.

As discussed last quarter, the portfolio's main overweights continue to be emerging markets and pro-cyclical sectors. We strongly believe that policy priorities around the world are now focused on generating growth and reflation of the real economy, as opposed to the prior decade's focus on inflating asset prices. Perhaps the best example of this is China's coordinated stimulus over the recent months, where tax cuts, bank reserve requirement ratio cuts, and support for private enterprises are starting to manifest themselves throughout the economy. The China manufacturing PMI Index has snapped back since the start of the year, indicating stronger economic activity and improved labor market conditions. Value-added tax cuts are starting to flow through to lower consumer prices and stronger purchasing power. Combined with more progress on the U.S.-China trade and tariff negotiations, reflation polices have driven Chinese equities up 18% to start the year.

Despite their strong gains however, emerging markets as a whole did not bounce as much as their counterparts in Europe and the U.K., mostly because they did not decline as dramatically in the prior quarter. This explains most of the portfolio's regional underperformance trends. However, we do not assign much weighting to such short-term performance figures, as they are largely noise and unrelated to the underlying investment theses in our holdings.

Additionally, emerging markets were impacted by some late-quarter weakness in the Brazilian market. Optimism for the country's newly elected reformist government was tempered after President Bolsonaro's first 100 days proved chaotic. In particular, his hardline negotiating style and inability to secure a working majority in Congress now threaten his administration's ability to make good on campaign promises of much-needed pension reform and debt reduction. Faced with rapidly declining approval ratings, though, it appears that Bolsonaro has more recently shown willingness to soften his tactics and re-engage the opposition. Overall, we remain constructive on the recovery in Brazil if the country is able to implement this much-needed fiscal reform.

At the sector level, the first quarter was dominated by a return to growth and momentum factors, with information technology (IT) stocks leading the charge. As in prior years, IT continues to be a challenging sector for us, as valuations remain expensive, and unprofitable/unsustainable business models continue to flood the market. While our tech holdings generally performed well in the quarter, we remain underweight the sector, as we do not see many ideas that warrant investment with a sufficient margin of safety.

Energy was another strong sector, and it contributed meaningfully to the portfolio's performance. After the fourth quarter's sharp drop, crude oil prices rebounded nearly 30%, led by Saudi production cuts, Iran/Venezuela sanctions and a weaker U.S. dollar. As investors feel increasingly comfortable that the global growth narrative remains on track, we believe demand for energy should remain strong through the summer months, and we remain meaningfully overweight the sector.

In addition to the rally in energy, we also had winners in the communication services and consumer staples sectors where company-specific execution stories drove strong stock price appreciation. Entertainment One, whose content franchises include Peppa Pig, PJ Masks and the Mark Gordon family of television shows, continues to benefit from the scarcity of premium media assets. Nomad Foods, a leader in the Western European frozen food market, consistently drove market share and category growth in its key must-win markets. Thai Union, one of the world's leading ambient seafood manufacturers, finally saw relief from high tuna prices. With lower input costs, and restructuring potential in its restaurant operations, we are optimistic on Thai Union's continued profit recovery this year.

Conversely, consumer discretionary and materials were the biggest detractors for the quarter. One major theme impacting both sectors was the recent weakness in Brazil, which pressured holdings such as Arcos Dorados and Duratex. However, as previously discussed, we remain confident in the new administration's efforts toward fiscal reform and believe that Brazil is a structurally attractive market where we intend to stay invested, particularly in companies leveraged to its large and improving consumer economy.

Another main detractor for the quarter was Just Group, a provider of retail and bulk annuity products in the U.K. Recent regulatory changes necessitated a capital raise during the quarter, which impacted the stock but also lifted some uncertainty regarding its capital position. Longer-term, consolidation and reduced competition have combined to create a stable pricing environment and opportunity for Just Group to take market share. Macro trends remain supportive, as the U.K. property market and credit quality metrics have outperformed consensus expectations.

Outlook and positioning

As the narrative of the Great Reversion continues to unfold, and policy and political agendas support recovery in the real economy, we see the long-suffering victims of the past long cycle as best positioned to benefit. Specifically, the main areas of contrarian opportunity continue to be emerging markets and the U.K. and cyclical value stocks hampered by fears of a global slowdown.

Emerging markets remain attractively priced and are among the leading beneficiaries of a dovish U.S. rate and dollar policy and global reflation. Major markets such as China and Brazil have tangible catalysts that should continue to drive economic recovery, and we also continue to explore names in Mexico and Southeast Asia, where market expectations remain low.

Despite the gloom and doom surrounding Brexit, the U.K. was actually the best-performing region in the first quarter. This is a great example of the contrarian mindset we often discuss with respect to our process. For several quarters now, attractive valuations have led us to add continuously to our U.K. holdings, particularly sectors exposed to the domestic economy, such as housing, staffing and banking. While the risks around Brexit remain, we believe they are well-known, and companies have been preparing for separation for two years. Though near-term economic activity has been hampered by the uncertainty, once a decision is finally reached, the U.K. will be able to move forward with newfound freedom to establish its own trade policies and business regulation.

Europe also continues to be an area of contrarian value where we have also added to the portfolio, particularly in cyclicals. Over the past year, eurozone stocks have been mired by weak domestic recovery and a large dependence on exports, particularly to emerging markets and China. As growth in its trading partners normalizes, Europe stands to be a derivative beneficiary. Additionally, from the policy angle the ECB remains committed to keeping monetary supply as accommodative as necessary, and low interest rates should be supportive of solid credit growth and improving labor market demand in the region. Upcoming European parliamentary elections in May could also set the stage for more expansionary policies to support growth.

Fund highlights

For the quarter ended March 31, 2019, the ClearBridge International Small Cap Fund — Class A shares had a cumulative return of 6.91%, excluding the effects of sales charges. In comparison, the Fund's unmanaged benchmark, the MSCI EAFE Small Cap Index, returned 10.65%.

On an absolute basis, the Fund had gains in 10 of the 11 sectors in which it was invested. The primary contributor to performance was the industrials sector.

In relative terms, overall stock selection and sector allocation detracted from performance. Stock selection in the consumer discretionary and materials sectors, as well as an underweight to IT, hampered relative results. Conversely, stock selection in the consumer staples sector and an overweight to energy contributed to relative performance.

On a regional basis, stock selection in Europe Ex UK and the United Kingdom hurt results, while stock selection in North America and an underweight to Japan proved beneficial.

On an individual stock basis, QGEP Participacoes, SBS Holdings, Entertainment One, CIMC Enric Holdings and Shanghai Haohai Biological Technology were the greatest contributors to absolute returns during the quarter. Positions in Criteo, Just Group, Honma Golf, Star Bulk Carriers and Kathmandu Holdings were the largest detractors from absolute performance.

In the first quarter, we initiated a number of new positions, the largest being Duetz, Bucher Industries and Galliford Try, in the industrials sector, CYBG, in the financials sector, and Criteo, in the communication services sector. We also closed several positions, the largest being Honma Golf and Kathmandu Holdings, in the consumer discretionary sector, Nomad Foods, in the consumer staples sector, and Doosan Bobcat and Europcar, in the industrials sector.

Top 10 equity holdings (%)	
Entertainment One Ltd	1.8
SBS Holdings Inc	1.8
i-SENS Inc	1.6
Shanghai Haohai Biological Technology Co Ltd	1.5
Chlitina Holding Ltd	1.4
CIMC Enric Holdings Ltd	1.4
Thai Union Group PCL	1.4
Ted Baker PLC	1.3
Sun Frontier Fudousan Co Ltd	1.3
QGEP Participacoes SA	1.3

Sector allocation (%)	
Industrials	28.8
Materials	12.7
Financials	12.0
Consumer Discretionary	9.5
Energy	6.3
Real Estate	6.2
Consumer Staples	5.6
Communication Services	4.6
Health Care	3.9
Information Technology	3.2
Utilities	2.6
Other	1.1
Cash/Other	3.4

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

Definitions and additional terms:

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

Brexit is an abbreviation of "British exit," which refers to the June 23, 2016 referendum by British voters to exit the European Union.

European Central Bank (ECB) is the central bank responsible for the monetary system of the European Union (EU) and the euro currency.

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.

"The Great Reversion" refers to the return to normal inflation, interest rates, volatility and other economic fundamentals.

MSCI EAFE Small Cap Index is an equity index that captures small-cap representation across Developed Markets countries around the world, excluding the U.S. and Canada.

The **Institute for Supply Management's composite PMI Index** (formerly the National Association of Purchasing Managers Index) is based on a survey of purchasing executives who buy the raw materials for manufacturing at more than 350 companies.

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What should I know before investing?

Equity securities are subject to price fluctuation and possible loss of principal. Small- and mid-cap stocks involve greater risks and volatility than large-cap stocks. 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. To the extent the Fund invests in fixed income, these securities are subject to various risks, including but not limited to credit, inflation, income, prepayment and interest rates risks. As interest rates rise, the value of fixed income securities falls. Derivatives, such as options and futures, can be illiquid, may disproportionately increase losses, and have a potentially large impact on Fund performance. The manager's investment style may become out of favor and/or the manager's selection process may prove incorrect, which may have a negative impact on the Fund's performance.

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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.

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