2Q 2019 | Product Commentary

MARTIN CURRIE EMERGING MARKETS FUND

Martin Currie Team-Managed Approach

- **Martin Currie is an active equity specialist that builds global, stock-driven portfolios based on fundamental research, devoting all of its resources to delivering optimum investment outcomes and superior client relationships.**
- **Legg Mason's unique structure provides you with access to this specialized expertise. We offer a powerful portfolio of products through our independent investment management firms.**

Average annual total returns and fund expenses (%)

as of June 30, 2019

	3-mo	1-yr	3-yr	Since Incept. (05/29/15)	Expenses Gross	Expenses Net
Class I	1.08	-1.24	12.19	5.90	1.38	1.00
MSCI Emerging Markets Index	0.61	1.21	10.66	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. 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 and/or reimbursed 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. These arrangements cannot be terminated prior to December 31, 2020 without the Board's 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 0.05 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.

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.

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

Key takeaways

- Trade tensions between the U.S. and China were a focus for investors. Talks have resumed but no current tariffs have been cut.
- The U.S. threatened (but didn't impose) tariffs on Mexican goods as part of plans to curb immigration.
- Many central banks cut rates over the period in response to concerns over the health of the global economy and trade tensions.

Market overview

Trade talks between China and the U.S. continued to dominate the headlines during the quarter and act as a trigger for sentiment. As hopes grew of a thawing in relations in June, the market recovered from its earlier sell-off and ended the quarter in positive territory. The U.S. and China did agree to restart trade talks, and although no current tariffs were reduced, the U.S. administration indicated it would hold off on 25% tariffs on US$300 billion of Chinese imports.

In late May there was also a flurry of headlines on another trade front, as the U.S. administration announced the imposition of 5% tariffs on Mexican goods unless its neighbour acted to curb migration. Then within two weeks, the U.S. declared that negotiations on immigration had been successful – meaning no new tariffs. This sequence illustrated the unpredictability of the tariff/trade issue and the difficulty of trying to anticipate news flow around trade tensions.

Central banks around the world turned more dovish in the second quarter on the back of subpar inflation releases and in response to the potential knock-on effects from trade tensions on global growth. June saw rate cuts in Chile (a surprise), Russia and India, as well as a raft of clearly dovish statements from central banks. The Federal Open Market Committee (FOMC) meeting in the U.S. in mid-June boosted emerging market (EM) sentiment, and the prospect of more U.S. interest rate cuts saw almost all EM currencies finish the quarter strongly.

Macro data globally was generally weak in the second quarter. South Africa's economy contracted very sharply in the first three months of 2019, with GDP falling at an annualised rate of 3.2% quarter on quarter, which is a significant drop in EM terms. Despite this eye-catching weakness, South African equities and the rand had a strong June, in line with several other slightly weaker EM countries. As is common in EM, there was a greater dispersion of returns across countries over the period than we saw at either a sector or equity-style level.

The recent shift in global interest rate policy from tightening toward a resumption of rate cuts should provide a boost to confidence and aid stability. It should also provide support to the intrinsic value of high-growth companies. While our strategy is typically exposed to companies with above-average earnings growth prospects and stronger-than-average balance sheets, an improvement in the overall corporate backdrop would help build confidence that the long-term growth drivers for emerging markets remain intact. This is also likely to be a necessary prerequisite to close the emerging market valuation gap to MSCI World.

We remain excited by the powerful combination of technology adoption, urbanisation and services sector growth that is evident in emerging markets. We expect our highly selective, stock-focused approach will continue to prosper through accessing companies with a high return on equity, operating in structurally growing industries.

We continue to have confidence in the growth drivers that we are accessing in key thematic areas. These areas include:

- Sustainable energy (LG Chemicals, Samsung SDI, China Gas and Cosan)
- Smart devices (Samsung Electronics, SK Hynix, TSMC, Sunny Optical, Largan Precision)
- Increased financial services adoption (Credicorp, Bank Rakyat, Banorte, HDFC Bank and Ping An)
- Disruptive technologies (Alibaba, Tencent, Naspers and EPAM)

Fund highlights

The Fund's Class I shares returned 1.08%, and the MSCI Emerging Markets index returned 0.61% for the quarter.

Key positive sectors for the portfolio were consumer discretionary and financials, with stock selection in Brazil – specifically through holdings in MRV and Cosan – a notable driver of positive performance.

At the stock level, Titan, MRV Engenharia and Cosan contributed the most. On the other side, not holding Gazprom and the holdings in OTP Bank and Shanghai Fosun Pharmaceutical weighed the most on returns.

During the quarter, we bought Indian banks ICICI and Kotak Mahindra and Brazilian insurance firm IRB Brasil Resseguros. We sold CTBC Financial Holding.

Top contributors

The leading individual contributors to the portfolio's relative performance over the quarter included:

Titan, in the consumer discretionary sector. Indian consumer company Titan reported strong quarterly results and management reiterated its positive long-term guidance. Titan continues to take market share in jewellery and is seeing significant progress, particularly in the wedding jewellery space. The company also benefited from the Indian backdrop being constructive during the period, as the political continuity stemming from the election result was well received. We also had a positive call with the company in the quarter.

MRV, in the consumer discretionary sector. The Brazilian housebuilder reported strong quarterly earnings (that were also better than expected) with robust sales. Market fears that the Brazilian government might fundamentally change housebuilding programmes have proved unfounded. MRV is a well-run company exposed to the structural undersupply of housing in Brazil.

Cosan, in the energy sector. The Brazilian holding company, with assets exposed to sugar prices and other resources, reported quarterly numbers with its new fuel distribution business in Argentina exceeding expectations. Results were strong across the board and the company reiterated ongoing expectations of recovery. The group also continued its further corporate simplification as it shifts from a commodity play to an integrated energy company.

Top detractors

The bottom individual contributors to the portfolio's relative performance over the quarter included:

Gazprom (not held), in the energy sector. Russia was a very strong market over the quarter, and energy company Gazprom is the biggest Russian stock in the EM universe that is not held in the portfolio. The rouble was also one of the strongest EM currencies over the quarter relative to the U.S. dollar. Gazprom's quarterly results beat expectations, thanks to currency gains, with a large dividend hike a focus for investors.

OTP Bank, in the financials sector. The Central and Eastern European bank underperformed over the quarter without any significant news. The fundamentals for OTP are very sheltered from global trade issues. In the short term, the stock can have periods where the share price is inversely correlated to broader EM sentiment, while outperforming over the longer term. Quarterly results showed that benign asset quality and high loan growth trends are intact for the company.

Shanghai Fosun Pharmaceutical, in the health care sector. This diversified Chinese health care stock reported quarterly earnings that highlighted elevated selling and research & development costs. Uncertainty over health care reform and (in particular) Chinese drug pricing has weighed heavily on the sector and the stock over the last year or so; little credit has been given to Fosun's diversified set of business drivers.

Definitions and additional terms

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 **Federal Open Market Committee (FOMC)** is the branch of the Federal Reserve Board that determines the direction of monetary policy.

Gross domestic product (GDP) is the market value of all final goods and services produced within a country in a given period of time.

MSCI is an investment research firm that provides indices, portfolio risk and performance analytics and governance tools to institutional investors and hedge funds.

The **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.

The **MSCI World Index** captures large- and mid-cap representation across Developed Markets countries.

Sector allocation (%)	
Financials	27.8
Information Technology	22.7
Consumer Discretionary	18.6
Communication Services	7.9
Materials	7.3
Energy	6.8
Health Care	3.5
Consumer Staples	2.2
Utilities	1.9
Real Estate	0.0
Industrials	0.0
Cash/Other	1.3

Top 10 equity holdings (%)	
Samsung Electronics Co Ltd	7.6
Tencent Holdings Ltd	6.7
Taiwan Semiconductor Manufacturing Co Ltd	6.4
Alibaba Group Holding Ltd	6.0
Naspers Ltd	3.6
Ping An Insurance Group Co of China Ltd	3.3
Titan Co Ltd	3.1
Industrial & Commercial Bank of China Ltd	3.1
Credicorp Ltd	2.8
AIA Group Ltd	2.7

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.

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- A broad mix of equities, fixed income, alternatives and cash strategies invested worldwide
- 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

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 focuses its investments in a single country or only a few countries in a particular geographic region, economic, political, regulatory or other conditions affecting such country or region may have a greater impact on Fund performance relative to a more geographically diversified fund. As a non-diversified fund, the Fund is permitted to invest a higher percentage of its assets in any one issuer than a diversified fund, which may magnify the Fund's losses from events affecting a particular issuer. The Fund may be significantly overweight or underweight certain companies, industries or market sectors, which may cause the Fund's performance to be more sensitive to developments affecting those companies, industries or sectors. Derivatives, such as options and futures, can be illiquid, may disproportionately increase losses, and have a potentially large impact on Fund performance. In addition to the Fund's operating expenses, the Fund will indirectly bear the operating expenses of any underlying Funds.