2Q 2019 | Product Commentary

QS U.S. SMALL CAPITALIZATION EQUITY FUND

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Average annual total returns and fund expenses (%)

as of June 30, 2019

Class C	3-mo	1-yr	5-yr	10-yr	Since Incept. (02/05/09)	Expenses Gross	Expenses Net
Excluding sales charges	-0.27	-9.20	3.80	11.61	12.13	1.92	1.92
Including effects of maximum sales charges	-1.25	-10.00	3.80	11.61	12.13	1.92	1.92
Russell 2000 Index	2.10	-3.31	7.06	13.45	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 C shares reflect a maximum one-year contingent deferred sales charge (CDSC) of up to 1.0%. 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 **Russell 2000 Index** is an unmanaged list of common stocks that is frequently used as a general performance measure of U.S. stocks of small and/or midsize companies. Please note that an investor cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

Market overview

U.S. small-cap equities, as measured by the Russell 2000 Index, generated positive returns (2.1%) but were quite volatile during the second quarter of 2019. The quarter started with a strong rally in April (3.4%), only to sharply decline in May (-7.8%) and rebound dramatically in June (7.1%). The risk-on/risk-off theme that has dominated financial markets over the past few years was also pervasive during the quarter, as most risky assets appreciated dramatically in April and June but exhibited dismal performance during May. The shifts in investor sentiment were propelled by the perception of a number of risks, including an escalation in the U.S.-China trade tariff war, uncertainty around Brexit, an inversion of the yield curve in the U.S. and soft global growth. These risks overshadowed several sources of investor optimism, which included a pivot to accommodative monetary policies by major central banks, positive economic data and a post-G20 meeting "tariff freeze" agreement between the U.S. and China.

Many of the trends observed during the first quarter of the year persisted into the second quarter, with small-caps lagging large-caps, value underperforming growth and cyclical sectors generally outperforming defensive counterparts. Industrials led overall, while two other cyclical areas—financials and information technology—finished third and fourth. The utilities sector was the exception; this is typically a more defensive sector, but it was the second-best performer amid the fall in interest rates. Energy stocks recorded the largest decline, echoing high volatility in oil prices.

Fund highlights

In the second quarter of 2019, the Fund's Class C Shares underperformed its benchmark, excluding the effects of sales charges. The diversified, multi-factor stock selection model results were volatile during the quarter. May was one of the most challenging months we have seen, as both traditional Value and Cash Flow factors turned in negative performance. June was better, with positive results in both Valuation and Sentiment, although Earnings Growth was not rewarded. Results for the quarter overall were driven by weak performance in Value, Cash Flow and Earnings Growth.

Stock selection results were most negative in the information technology, consumer discretionary and health care sectors, more than offsetting positive selection in the banks and communication services sectors. Sector allocation decisions, including an underweight to health care and an overweight to banks, added modest value.

At quarter end, the portfolio was attractively valued with a lower 12-month forward P/E than that of the benchmark. In line with our well-balanced and disciplined process, the portfolio continues to be diversified across sectors and factors, and well exposed to all elements of the stock selection model. Sector level exposures were close to the benchmark.

U.S. outlook

Growth expectations across the globe remain low, and as a result central banks continue to hint toward more expansionary policies. In the U.S., the Federal Reserve "dot plot" shows that seven policymakers are forecasting a 50-basis-points cut by year end. A more dovish Fed coupled with an impasse in the trade tariff conflict between the U.S. and China has renewed investor optimism. However, many of the sources of uncertainty that roiled markets in May continue to be a cause for concern. We believe that our well-diversified, disciplined strategy is positioned to benefit in this environment.

Top 10 equity holdings (%)	
Essent Group Ltd	0.8
Etsy Inc	0.8
Sanderson Farms Inc	0.8
Insperity Inc	0.8
MGIC Investment Corp	0.8
KB Home	0.8
Dana Inc	0.7
Deckers Outdoor Corp	0.7
Sinclair Broadcast Group Inc	0.7
Tetra Tech Inc	0.7

Sector allocation (%)	
Financials	18.0
Health Care	16.6
Information Technology	15.2
Industrials	14.7
Consumer Discretionary	11.1
Real Estate	6.7
Utilities	3.8
Materials	3.8
Communication Services	3.5
Energy	3.5
Consumer Staples	2.2
Other	0.0
Cash/Other	0.7

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.

Definitions and additional terms

Brexit is an abbreviation for "British exit," referring to the UK's decision in a June 23, 2016 referendum to leave the European Union (EU).

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 **forward price-to-earnings (forward P/E)** ratio is similar to the price-to-earnings ratio. While a regular P/E ratio is a current stock price over its earnings per share, a forward P/E ratio is a current stock's price over its "predicted" earnings per share.

The **Group of 20, or G20**, is a group of finance ministers and central bank governors from 19 of the world's largest economies, including those of many developing nations, along with the European Union.

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Clarion Partners

ClearBridge Investments

EnTrustGlobal

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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. Derivatives, such as options and futures, can be illiquid, may disproportionately increase losses, and have a potentially large impact on Fund performance. Potential active and frequent trading may result in higher transaction costs and increased investor liability. The Fund is more susceptible to any economic, business, political, regulatory or other developments that adversely affect issuers in the financial services industry than a Fund that does not concentrate its investments in the financial services industry.

Any information, statement or opinion set forth herein is general in nature, is not directed to or based on the financial situation or needs of any particular investor, and does not constitute, and should not be construed as, investment advice, a forecast of future events, a guarantee of future results, or a recommendation with respect to any particular security or investment strategy or type of retirement account. Investors seeking financial advice regarding the appropriateness of investing in any securities or investment strategies should consult their financial professional.

References to specific securities are not intended and should not be relied upon as the basis for anyone to buy, sell or hold any security. Investors seeking financial advice regarding the appropriateness of investing in any securities or investment strategies should consult their financial professional.

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.

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.LEGGMASONFUNDS.COM. PLEASE READ THE PROSPECTUS CAREFULLY.