Portfolio Manager Commentary

ClearBridge Advisors
A Legg Mason Company

Opportunity Strategy

3Q11

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Market Review

We have maintained a pro-cyclical approach to the stock market, believing that the U.S. and world economies need growth in order to effectively deal with their fiscal problems, which include entitlements and debt.

This means that sectors of the market such as industrials and technology have been favored over defensive ones such as utilities and staples. Although our financials holdings were very poor performers during the quarter, they essentially matched the performance for the benchmark financials sector. At current prices, oil services companies are one of the most compelling segments within the stock market.

Strategy Highlights

During the third quarter, stock selection and interaction in the consumer discretionary and information technology (IT) sectors contributed positively to relative performance, whereas stock selection and interaction in the energy and consumer staples sectors detracted from relative performance.

Relative to the Russell 3000 Value Index, at the end of the third quarter, the Strategy's largest overweight positions were in the information technology and industrials sectors. The Strategy's largest relative underweight positions at the end of the period were in the utilities and financials sectors.

> **"If the challenges associated with Europe did not exist, we would be 'all in' where our own stock market is concerned."**

The leading individual contributor to Strategy performance during the third quarter was Cisco Systems Inc. in the IT sector. Leading individual detractors from Strategy performance included JPMorgan Chase & Co., Morgan Stanley and Jones Lang LaSalle Inc. in the financials sector and Hess Corp. and Baker Hughes Inc. in the energy sector.

During the quarter, we added new positions to the Strategy portfolio in Annaly Capital Management Inc. in the financials sector and Apache Corp. in the energy sector.

We sold out of existing Strategy positions in Babcock & Wilcox Co. in the industrials sector, Bank of America Corp. in the finanicials sector, Enzo Biochem Inc. in the health care sector and United States Steel Corp. in the materials sector.

Outlook

What are the prospects for stocks in the next quarter and year? From time to time we monitor what insiders are doing, and buying vs. selling has reached levels consistent with a market near an important bottom. With these factors in mind, we believe our emphasis on sectors that would benefit from a better stock market is appropriate.

The wild card in all of this is Europe. European banks are undercapitalized and need equity injections. Greece has defaulted, for all practical purposes, and if one concludes that "haircuts" and write-downs associated with Greek debt are appropriate, host governments need to inject equity capital in return for partial ownership positions. Existing shareholders are resisting this, which is to be expected. In addition, Europe needs a Eurobond or "umbrella security" to deal with the several trillion dollars of government debt that must be backstopped. If the challenges associated with Europe did not exist, we would be "all in" where our own stock market is concerned.

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